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IN THE
Supreme Court of the United States
OCTOBER TERM, 1976

No. 76-

76-1499

CHARLES G. RODMAN, AS TRUSTEE OF THE ESTATE OF
W. T. GRANT COMPANY, BANKRUPT,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE
SECOND CIRCUIT**

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v.

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Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
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SECOND CIRCUIT**

Petitioner, Charles G. Rodman, as Trustee of the Estate of W. T. Grant, Bankrupt, prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding February 3, 1977.

Opinions Below

The memorandum and order, order, and decision (entered June 17, 1975) of the United States Tax Court are not reported; they are reprinted in Appendix C, *infra*, pp. 46a-50a. The opinion of the United States Court of Appeals for the Second Circuit, affirming the Tax Court, is reported at 548 F.2d 1109 (1977); together with the judgment entered February 3, 1977, it is reprinted as Appendix D, *infra*, pp. 51a-58a.

Prior proceedings in this case are reflected in an opinion of the Tax Court (Appendix A, *infra*, pp. 1a-35a), reported at 58 T.C. 290 (1972), and an opinion of the United States Court of Appeals for the Second Circuit (Appendix B, *infra*, pp. 36a-45a), reversing the 1972 Tax Court decision, reported at 483 F.2d 1115 (1973), *cert. denied*, 416 U.S. 937 (1974).

Jurisdiction

The opinion of the court of appeals was handed down February 3, 1977. The judgment of the court of appeals was entered on the same day (Appendix D, *infra*, p. 58a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether the revolving credit plan tax regulations, mandating unique proof procedures requiring special treatment of finance charges, regulations by their terms applicable solely to revolving credit plans, may be applied by the Commissioner of Internal Revenue to installment plans that are not revolving credit plans, thereby precluding proof by standard means and requiring treatment of finance charges that is prohibited by section 453(a)(2) of the Internal Revenue Code.

2. Whether the court of appeals was correct in refusing the Trustee's request for a remand which would enable the Trustee to submit evidence showing that the Internal Revenue Service consistently has interpreted and applied the regulations to the Bankrupt's competitors in a manner exactly contrary to the Commissioner's position and the court of appeals' holding in this case.

Statute and Regulations Involved

The pertinent statute is section 453 of the Internal Revenue Code of 1954. The pertinent regulations are promulgated under section 453. The relevant portions of the statute and regulations are reprinted in Appendices E and F, *infra*, pp. 59a-85a.

Statement

W. T. Grant Company ("Grant") is a Delaware corporation with its principal offices in New York City. During the taxable years in issue, ended January 31, 1964 and 1965, and thereafter until adjudged a bankrupt on April 13, 1976, Grant sold variety goods in more than one thousand stores throughout the United States. Grant qualified as a dealer in personal property under section 453 of the Internal Revenue Code, governing the deferral of income from sales under installment plans.

In its retail business Grant, in addition to cash sales, sold merchandise under three customer credit plans: A traditional installment plan, a revolving credit plan, and—in issue here—a coupon book installment plan (the "Grant Plan"). Under this plan, Grant issued to a customer a book of coupons, immediately redeemable for merchandise, in a fixed dollar amount for which the customer was required to make payment over a period of not less than four nor more than eighteen months (in later years the Grant Plan was revised to allow customer payment over a term substantially longer than eighteen months). Required customer payments were in equal monthly installments determined at the time of issuance of the coupon book; the customer was not billed monthly. Required customer payments totalled the redemption value of the coupons plus a pre-determined finance charge (*e.g.*, for \$100 of coupons,

payment of \$10 per month for 11 months). Coupons were immediately exchangeable by the customer for merchandise at any of Grant's stores. Since each coupon book was numbered, it was identifiable to a particular installment contract. However, due to the enormous volume of coupons exchanged for merchandise, Grant did not identify and record the exchange of each coupon by customer account.

The redemption of coupons for merchandise, and not the initial issuance of coupons, was treated as a sale for tax and financial accounting purposes. Utilizing the installment reporting provisions under section 453(a) of the Internal Revenue Code,¹ Grant reported income each year to the full extent of profits on payments received from customers. In accordance with section 453(a)(2), finance charges were reflected in the installment sale computation and were not treated as interest income.

The Commissioner of Internal Revenue determined that sales of merchandise under the Grant Plan did not qualify as installment sales for federal income tax purposes, and that no part of the income under the Grant Plan could be deferred, although payment to Grant was in fact deferred or was never received at all.² Grant then petitioned the Tax Court under 26 U.S.C. §§ 6213(a) and 7442.

In the first Tax Court proceeding (1972), that tribunal found the Grant Plan a "traditional" installment plan within the meaning of § 1.453-2(b)(1) of the controlling tax regulations, and awarded Grant installment (tax deferred) treatment on 100% of its Plan sales. On appeal (1973), the

1. All "section" references are to the Internal Revenue Code of 1954, as amended.

2. Grant's bankruptcy proceeding (Bankruptcy No. 75 B 1735 S.D.N.Y.) confirmed in excess of \$426 million in uncollected customer receivables, a large part of which (in excess of \$100 million) arose out of the Grant Plan. In a court supervised bulk sale of over \$400 million of the receivables on November 15, 1976, the Trustee sold to an independent buyer for approximately ten cents on the dollar.

Second Circuit held the Grant Plan was not a "traditional" installment plan, but rather was a "non-traditional" installment plan under § 1.453-2(b)(2) of the regulations. A traditional plan dealer is not required to prove facts as to customer payments; a non-traditional plan dealer must demonstrate the portion of sales paid for in two or more payments. More importantly, the court of appeals concluded the Grant Plan was a revolving credit plan. The revolving credit plan regulations, § 1.453-2(d), establish special proof procedures which, by their terms, are exclusively applicable to revolving credit plans. Grant did not possess the customer account data required to satisfy those special revolving credit plan proof procedures. For lack of this evidence, which was not relevant under the theory on which the Tax Court held for Grant, the court of appeals reversed and remanded.

Maintenance by Grant of the voluminous individual customer account records contemplated by the revolving credit plan proof procedures would have been extremely burdensome and to no commercial purpose. The cost to Grant would have been enormous and, because the Grant Plan was not operated as a revolving credit plan, the business value of the data would have been nil. However, based upon the records it had maintained and statistically valid sampling procedures designed by Grant's independent accountants—procedures appropriate to the Grant Plan and as statistically accurate as the revolving credit plan proof procedures—Grant was prepared to demonstrate the portion of its Plan sales that in fact were paid for in two or more payments.

Grant filed a Motion for Further Trial in the Tax Court, seeking an opportunity to introduce this evidence. Believing the court of appeals' revolving credit plan conclusion to have foreclosed all issues, the Tax Court refused to hear the evidence and on June 17, 1975 entered decision for the

Commissioner. Grant appealed. On April 13, 1976, Grant consented to its adjudication as a bankrupt, Charles G. Rodman (the "Trustee") qualified as trustee of the Estate of W. T. Grant Company, Bankrupt, and was substituted for Grant in the appellate proceeding.

In that proceeding the Trustee pointed out that the court of appeals had erred, in its 1973 opinion, in stating the Grant Plan was a revolving credit plan. Acknowledging the error, the court of appeals nonetheless reaffirmed its prior holding that only the revolving credit plan proof procedures may be used. The court stated:

The fact that the plan was referred to as a "revolving credit plan" by this court was irrelevant to the basis of our decision [on first appeal] which rested on the particular features of the plan, not on reference to it as a revolving credit plan. [Appendix p. 56a]

As to the "particular features" of the Grant Plan, the court of appeals said:

The Internal Revenue Code and Regulations . . . permit installment reporting of income under . . . non-traditional installment plans only if records are kept, pursuant to § 1.453-2(d)(3),³ which establish whether or not a particular purchase was in fact paid for in two or more installments. . . . [Appendix p. 55a]

The common feature of all [revolving credit] plans, shared by the Grant coupon plan, is that it is impossible to determine whether any particular sale is in fact paid for in two or more installments unless records for each sale are kept. A customer purchasing an item on the coupon plan could, for example, prepay the entire outstanding balance in a single payment, or such a customer could make

3. The revolving credit plan proof procedures.

one or more small purchases, all of which would be completely paid for by a single installment payment on the coupon plan. Under such non-traditional credit plans a percentage of charges may not be treated as installment sales, unless a taxpayer maintains records pursuant to Treas. Reg. §§ 1.453-2(d)(2), (3) which enable him to determine on the basis of a sample analysis, what percentage of sales are eligible for installment plan tax treatment. [Appendix pp. 55a-56a]

In support of his position that the regulations do not subject coupon plans, which are not revolving credit plans, to the exclusive governance of the revolving credit plan proof rules, the Trustee requested a remand to demonstrate that, prior to and during the taxable years in issue, and thereafter at least through 1973,⁴ the Internal Revenue Service uniformly accepted from Grant's competitors proof of installment sale qualification for coupon plan sales by means other than the revolving credit plan proof procedures. The court refused the requested remand, stating (Appendix p. 56a n.3), "Rodman now seeks to introduce evidence concerning treatment of other comparable credit plans by the IRS in support of his argument on appeal. We may not consider such evidence first offered at this stage."

The aggregate deficiency asserted for the two taxable years in issue, approximately \$9,800,000, has been collected by the Commissioner. In the bankruptcy proceeding (Bankruptcy No. 75 B 1735 S.D.N.Y.) the Commissioner filed an amended proof of claim for federal income taxes and accrued interest, for Grant's ten taxable years 1966-1975, totaling in excess of \$84 million. The tax claim

4. In 1974 the Internal Revenue Service published Rev. Rul. 74-442, 1974-2 Cum. Bull. 152 which, for the first time, publicly announced the Service would require proof of installment sale qualification based on individual customer coupon redemption records.

relates primarily to the installment qualification of sales under the Grant Plan, which Grant maintained and expanded during the first nine of those years. If the Commissioner's tax claim and the claims of secured and other priority creditors are upheld, it currently appears that nothing may be left to distribute to the approximately 15,000 unsecured creditors, mainly suppliers, of Grant.

Reasons for Granting the Writ

The decision of the Second Circuit in this case wholly unsettles an important area of tax law, one which prior to the decision reflected clear, consistent and workable rules. Without any basis in precedent and contrary to the statutory and regulations' directive and to longstanding administrative interpretation, the court of appeals held the proof procedures of the revolving credit plan regulations applicable to an installment plan that was not a revolving credit plan, and excluded the application of any other proof procedures to that plan. In so doing the court failed to observe that the unique revolving credit plan procedures are not mere record keeping provisions. They require special treatment of finance charge income. In 1964 legislation Congress had reserved this special finance charge treatment to revolving credit plan sales, and had directed entirely different treatment of finance income earned incident to other types of installment sales. Absent action by this Court, a cloud of confusion will hang over what was long and, until the recent decision, rightly deemed a clear area of important tax law.

I.

The rules governing the tax treatment of installment plan dealers, settled by Congress in 1964, were clear and workable prior to the decision of the court of appeals in this case.

An installment plan contemplates two or more payments by the customer and finance charge that is either separately identified or added as part of the contract price of the merchandise (time price differential). In 1964 Congress addressed both features and formulated a set of clear and workable tax rules.

A. Proof of installment sale qualification.

Current tax law developed in reaction to the decision in *Consolidated Dry Goods Company v. United States*, 180 F.Supp. 878 (D. Mass. 1960). That case held *all* sales under a revolving credit plan qualified for installment (tax deferred) treatment. The Commissioner was displeased, Rev. Rul. 60-293, 1960-2 Cum. Bull. 163, and the Treasury Department proposed corrective amendments to the section 453 dealer installment sale regulations. 27 F.R. 9920 (October 9, 1962).

The 1962 proposed regulations recognized two and only two types of installment plan. First, the traditional plan calling for the sale of a single item of personal property, contractually requiring two or more payments, and automatically qualifying for installment treatment. Second, the revolving credit plan, newly and precisely defined in § 1.453-2(d)(1), under which the percentage of sales in fact paid for in two or more payments, and thus qualifying for installment treatment, would be annually determined by applying a prescribed sampling and statistical technique to

data contained in the customer account records regularly maintained by the dealer in the ordinary course of its revolving credit plan sales activity.

Altered in only one respect here relevant, the proposed regulations were promulgated in final form on October 15, 1963. T.D. 6682, 28 F.R. 11176. The precisely crafted definition of a revolving credit plan was not changed. But the catalog of cognizable installment plans was expanded to include plans that are neither traditional nor revolving credit.

The 1963 final regulations provide for traditional installment plans and non-traditional installment plans, the latter defined to encompass any plan the terms and conditions of which contemplate multiple payments, but under which some sales in fact may be paid for in only one payment—because the customer may elect to prepay in full, or because the customer's purchases in a single month may aggregate less than the payment next due. Regulations, § 1.453-2(b). Under a non-traditional installment plan, only those sales that in fact attract two or more payments qualify as installment sales.

The revolving credit plan is cataloged in the 1963 final regulations as one type of non-traditional installment plan. The revolving credit plan proof procedures are retained, § 1.453-2(d)(2)-(3), applicable exclusively to revolving credit plan sales. No special proof procedures are prescribed for any other type of non-traditional installment plan; it would have been impossible to design in 1963 specific proof rules for a myriad of plans either not in focus or not then in existence. The regulations merely impose a general requirement that the dealer must maintain such records as are necessary to clearly reflect income in accordance with sections 453 and 446 of the Code and § 1.446-1 of the regulations. See Regulations, §§ 1.453-1(f), 1.453-2(e)(1).

In P.L. 88-539 (August 31, 1964), Congress adopted the installment sale qualification rules of the 1963 regulations.⁵

B. Treatment of finance charge income.

Prior to the 1964 legislation the installment method dealer's billing practice determined the tax character of its finance income. Finance charge added to the price of merchandise was proceeds of sale eligible for installment reporting. Finance charge identified as interest on the invoice to the customer was separately accruable interest income. Rev. Rul. 64-126, 1964-1 (Part 1) Cum. Bull. 170. The 1963 regulations reflected this historic disparate treatment.

In P.L. 88-539 (August 31, 1964), Congress rejected as unsound the historic notion that the dealer's billing practice determines the tax character of its finance income. See S. Rep. No. 1242, 88th Cong., 2d Sess. 2 (1964). With retroactive effect, Congress enacted sections 453(a)(2) and 453(e), establishing the rules that now govern the tax treatment of installment sale finance charges earned by dealers in personal property.

First, except in the case of a revolving credit plan sale, tax consequence to the installment plan dealer is independent of billing practice. For tax purposes it is irrelevant whether the finance charge is separately stated (*i.e.*, identified in the invoice as interest, service charge, carrying charge, etc.), or simply is included as a time price differential in the charge for merchandise.

Second, whether or not separately identified in the customer invoice, finance charge income added contemporaneously with the sale on the dealer's books of account is

5. S. Rep. No. 1242, 88th Cong., 2d Sess. 4 (1964). P.L. 88-539 retroactively revoked a contrary determination that Congress had made six months earlier in § 222 of the Revenue Act of 1964, P.L. 88-272 (February 26, 1964).

treated as part of the installment sale and not as interest income, subject to one exception.

Third, the sole exception: If the sale is under a revolving credit plan,⁶ monthly finance charge is separately accrued as interest income and each payment received from the customer is bifurcated. A portion equal to the accrued interest is applied to discharge the accrual; the balance is treated as a payment for merchandise sold on the installment plan.⁷

C. Summary.

The following summarizes the scheme of taxation, formulated by the described amendments to the Code and regulations, and uniformly observed prior to the decision of the court of appeals in this case.

1. *Traditional installment plans*—Each sale qualifies automatically for installment treatment. No proof is required that the customer actually paid in two or more payments. Whether finance charge is separately stated in the invoice or built into the contract price of the goods sold, no portion constitutes interest income to the dealer and all proceeds qualify for installment treatment.

6. Both section 453(a)(2) and the Senate Finance Committee Report refer to a "revolving credit type plan." The statute does not define the term and the Committee Report makes it clear Congress looked for definitional content to the 1963 dealer installment sale regulations. The regulations, §1.453-2(d)(1), furnish a precise comprehensive definition of the term "revolving credit plan." They do not separately define a "revolving credit type plan," but simply treat the two terms as synonymous and interchangeable. See §§ 1.453-1(a)(1), 1.453-2(b) (last sentence of flush language), 1.453-2(c)(2) [interpreting Code section 453(a)(2)].

7. On March 4, 1965, in T.D. 6804, 30 F.R. 2841, the Treasury amended the dealer installment sale regulations to reflect the treatment of finance charge income mandated by sections 453(a)(2) and (e) of the Code. Like the statutory changes, the amendments to the regulations had retroactive effect.

2. *Revolving credit plans*—Only a percentage of sales under a revolving credit plan qualifies for installment reporting. The percentage is determined under the detailed specially formulated revolving credit plan proof procedures which use as their statistical base customer account data regularly maintained by the revolving credit plan dealer in the ordinary course of its retail operation. Finance charges are not treated as part of the installment sale. The dealer is required to accrue finance charges as interest income, and to apply subsequent customer payments, as received, first to discharge the accrual, with any balance of payment treated as an installment sale receipt. See Regulations, §1.453-2(d)(4) Example (3), added in 1965 by T.D. 6804.

3. *Non-traditional installment plans that are not revolving credit plans*—The dealer must prove the portion of plan sales which in fact are paid for in two or more installments and thus qualify for installment sale treatment. The regulations do not prescribe the mode of that proof, and merely impose a general requirement that the dealer must maintain such records as are necessary to clearly reflect income. See Regulations, §§ 1.453-1(f), 1.453-2(c)(1). Whether or not separately stated in the invoice to the customer, finance charges reflected on the dealer's books are treated as part of the installment sale and not as interest income to the dealer.

II.

The decision of the court of appeals is contrary to the statute and gravely upsets important settled law.

In its 1973 decision on first appeal, the court of appeals found the Grant Plan a revolving credit plan. Because Grant had not maintained the particularized records required by the revolving credit plan proof procedures, the court held sales under the Grant Plan ineligible for installment reporting.

In its 1977 decision on second appeal, the court of appeals recognized that the Grant Plan, while a non-traditional installment plan, was not a revolving credit plan. Nonetheless, the court reaffirmed its prior holding that the revolving credit plan proof procedures, and only those special proof procedures, apply to the Grant Plan. In so holding the court looked to common features of revolving credit plans and of the Grant Plan: (1) the customer may elect to prepay at one time the entire balance of his indebtedness; (2) the customer may make one or more small purchases the total cost of which does not exceed the payment next due from the customer. In either event, the statutorily required two or more payments will be absent.

But the features that attracted the court's attention are the features that define *all* non-traditional installment plans (revolving credit plans and a host of other non-traditional plans) and distinguish them from the traditional plan under which no proof of facts as to payment is required. The court failed to focus on the distinction between revolving credit plans and non-traditional plans which do not share the special characteristics that identify revolving credit plans. See Regulations, §§ 1.453-2(d)(1), 1.453-2(d)(6)(i)-(iii). Illustrating the significance of the court's failure to distinguish between revolving credit plans and other non-traditional installment plans are the following cases in point.

Elective prepayment plan. A plan requiring that each sale be paid for in three monthly installments commencing next year is a traditional plan. However, if the customer by right may elect to prepay within thirty days in order to gain a 3% discount, the plan is a non-traditional installment plan. Rev. Rul. 71-595, 1971-2 Cum. Bull. 223. But it is not a revolving credit plan.

Initial deposit credit plan. The plan requires the customer deposit \$50 at entry, permits purchases of up to

twenty times that amount during the next three months, and provides for a single billing 30 days thereafter in an amount equal to total purchases, less \$50 deposited, plus interest. If the dealer's taxable year closes at the end of entry month and during that month the customer has made only small purchases the total cost of which does not exceed the \$50 deposit, there is only one payment. Had the customer purchased a \$60 item, it would be paid for in two payments, the deposit of \$50 and a later bill of \$10 plus interest. Thus, the initial deposit credit plan is a non-traditional installment plan. But it is not a revolving credit plan.

Take down plan. On July 1, 1977 the customer agrees to purchase from a calendar year dealer's stockpile 100,000 tons of manganese ore at a base price of \$30 per ton, a total of \$3 million for the lot. Under the plan the customer may purchase at one time or from time to time during the ensuing 36 months. Without regard to dates of purchase, under the take down plan the customer is obliged to pay \$1 million (one-third of the total purchase price) on February 1, 1978, 1979 and 1980. Alternatively, the customer may elect to pay a discounted \$2,700,000 on January 1, 1978 in discharge of his total obligations. For two reasons the take down plan is a non-traditional installment plan: it contemplates three payments but (1) the customer may elect to prepay in full on January 1, 1978, and (2) without regard to prepayment, total purchases in 1977 may aggregate less than the \$1 million to be paid on February 1, 1978. While clearly a non-traditional plan, the take down plan is not a revolving credit plan.

Under § 1.453-2(d)(1) of the regulations, none of the three plans described is a revolving credit plan. But, under the reasoning of the court of appeals, each would be subject to the revolving credit plan proof procedures to the exclu-

sion of any other method of proof. Indeed, the court's opinion is explicit on the point:

The Internal Revenue Code and Regulations issued thereunder . . . permit installment reporting of income under . . . non-traditional installment plans only if records are kept, pursuant to § 1.453-2(d)(3), which establish whether or not a particular purchase was in fact paid for in two or more installments. * * * [Appendix p. 55a]

The proof procedures provided in § 1.453-2(d) were designed to cover this situation—sales where a large number are expected to be paid and are paid in installments, but may also be and are in some cases paid in full. [Appendix p. 56a]

The court of appeals was gravely in error. Application of the revolving credit plan proof procedures to a plan that is not a revolving credit plan—a coupon plan, an elective prepayment plan, an initial deposit credit plan, a take down plan, or any other—is inconsistent with the regulations and impermissible under the governing statute.

First, in some cases the revolving credit plan proof procedures will not work at all. An example is the initial deposit credit plan. No matter how many sales in fact are paid for in two or more payments, the revolving credit plan proof procedures invariably announce the percentage of qualifying installment sales is zero. See Regulations, § 1.453-2(d)(3)(ii).⁸ The revolving credit plan proof procedures simply were not “designed to cover this situation.”

Second, in some cases application of the revolving credit plan proof procedures will subject the non-traditional installment plan dealer to inordinate senseless expense. With no less accuracy and at a fraction of the cost, sales

8. In his brief in the court of appeals, the Trustee stated the example case and the zero percentage conclusion. In his responding brief the Commissioner admitted the Trustee had correctly analyzed the regulation.

qualifying for installment treatment can be determined using a means of proof of which the Commissioner, on another day and in a closely analogous area, has published his approval. As explained in Part III of this petition, the Grant Plan is a case in point.

Third, and most important, section 453(a)(2) of the Code forbids application of the revolving credit plan proof procedures to a plan that is not a revolving credit plan. Under the revolving credit plan proof procedures, finance charge must be booked to the customer's account, and must be treated as interest income separate and apart from the installment sale. See Regulations, §§ 1.453-2(d)(2)-(3), 1.453-2(d)(4) Example (3). However, if the sale is not under a revolving credit plan, section 453(a)(2) requires that the finance charge be treated as part of the installment sale contract price and not as interest income.

The revolving credit plan proof procedures, by their explicit terms, apply only to revolving credit plans. The limitation is consonant with the mandate of section 453(a)(2). In extending the reach of the revolving credit plan regulations the court of appeals ignored the statute. This determination was plainly wrong. The potential adverse impact of the court's decision is vast. Retail dealers throughout the country maintain unnumbered non-traditional installment plans that are not revolving credit plans. These dealers account for finance charge income as part of the installment sale, as section 453(a)(2) requires. If, as the court of appeals determined, the revolving credit plan proof procedures were applicable to such non-traditional plans, all of these dealers have reported and continue to report incorrect federal income tax liability each year.

III.

The proof of qualifying installment sales proffered by the Trustee is appropriate under well accepted doctrine in the tax law.

In operating the Grant Plan, Grant did not regularly maintain the voluminous individual customer account records contemplated by the revolving credit plan proof procedures. To have done so would have been senselessly burdensome: the cost to Grant would have been enormous and, because the Grant Plan was not a revolving credit plan, the business value of the data would have been nil.

With respect to its coupon plan, Grant did develop and maintain the data needed to furnish proof of qualifying installment sales by a reasonable and far less costly method appropriate to Grant's experience and circumstances. This proof is based in significant part on a statistically valid sampling of actual merchandise sales to Grant's coupon plan customers. Using this data, the Trustee is able to prove the portion of Grant Plan sales qualifying for installment treatment with the same degree of accuracy as is obtained under the revolving credit plan proof procedures. See Rev. Proc. 64-4, 1964-1 (Part 1) Cum. Bull. 644.

It is a basic notion of the tax law that when a volume of sales or other transactions is in issue and item by item analysis is therefore impractical, facts may be proved through the use of acceptable statistical and sampling methods appropriate to the taxpayer's experience and circumstances. Indeed, if a specific method of statistical proof is put forth in applicable regulations, it is offered as a "safe harbor."⁹ The taxpayer may furnish proof in accordance

9. The revolving credit plan proof procedures appear to be the sole exception to the "safe harbor" rule. These exclusive procedures were developed in extensive consultation between Treasury and industry representatives and use as their sampling base the universe

with the stated method or, electing to use a different method of its own design, must demonstrate its method is reasonable in the circumstances. See, *e.g.*, Regulations, §§ 1.47-1(e) (2)(i) [investment credit: mass assets], 1.167(a)-11(d) [ADR depreciation: repairs], 1.451-4 [trading stamps], 1.472-8(e)(1) [dealer's LIFO inventory computations]. See also § 1.482-2(e)(1)(iv) [many separate sales or sales of many different products to a related taxpayer].

Because the redemption of a volume of merchandise coupons is at the heart of this case, the tax treatment accorded issuers of trading stamp coupons (*e.g.*, "green stamps") provides an instructive analogy. In computing taxable income a trading stamp company is allowed a deduction for estimated future redemptions of the large number of trading stamp coupons it has issued. The regulations, § 1.451-4, authorize computation of that deduction through the use of a probability sampling technique of the taxpayer's own design based upon standard statistical sampling principles and formulated to produce a reasonably accurate result. The trading stamp regulation does not offer additional guidance but the Commissioner, in Rev. Proc. 72-36, 1972-2 Cum. Bull. 771, has volunteered guidelines. They state:

The taxpayer may use any sampling procedures that are in accord with generally accepted probability sampling techniques. [§ 5.02].

The taxpayer is required to choose a method that is appropriate to his experience and circumstances. [§ 8].

The Trustee's proof accords in all respects with these precepts.

of customer account records which the revolving credit plan dealer must in any event maintain in order correctly to bill its customers each month. The proof procedures are thus uniquely appropriate to a revolving credit plan. The procedures are entirely inappropriate to an installment plan which is not a revolving credit plan and under which required customer payment and the quantum of finance charge are not a function of a shifting account balance. The dealer offering this type of installment plan has no business reason to maintain revolving credit plan type records.

IV.

The court of appeals arbitrarily foreclosed the Trustee's opportunity to demonstrate that the Commissioner's treatment of the Grant Plan was at odds with the more favorable treatment contemporaneously accorded similarly situated taxpayers.

Before the court of appeals the Trustee requested a remand to demonstrate that, prior to and during the taxable years in issue, and thereafter at least through 1973, the Internal Revenue Service uniformly accepted from Grant's competitors proof of installment sale qualification for coupon plan sales by means other than the revolving credit plan proof procedures. The court of appeals refused the requested remand, stating (Appendix p. 56a n.3), "Rodman now seeks to introduce evidence concerning treatment of other comparable credit plans by the IRS in support of his argument on appeal. We may not consider such evidence first offered at this stage."

The evidence was not untimely offered. In the first Tax Court proceeding (1972), the issue was whether the Grant Plan qualified as a traditional installment plan. Grant won. The court of appeals reversed and remanded (1973). Under the remanding mandate the Tax Court, in its 1975 proceeding, would not and properly could not consider new evidence. See *United States v. Fernandez*, 506 F.2d 1200 (2d Cir. 1974). On the second appeal (1977), the court of appeals should have considered whether the evidence if forthcoming would be material to the outcome. An affirmative conclusion should have secured a remand so that the evidence could be evaluated by the Tax Court. *United States v. Fernandez, supra*.

The Commissioner argued, and the court of appeals held, that a coupon book installment plan must be subjected

to the revolving credit plan proof procedures. Confirmation of a consistent contrary position by the Internal Revenue Service, uniformly according different and more favorable tax treatment to Grant's competitors, is plainly "material to the outcome."

A. Alternate proof is permissible.

"Persuasive evidence" of the correct interpretation of the regulations is "the interpretation put upon the [regulations] by the agency charged with the responsibility of administering the revenue laws." *Hanover Bank v. Commissioner*, 369 U.S. 672, 686 (1962). Consistent longstanding administrative recognition of other modes of coupon plan proof, proof different from the method prescribed in the revolving credit plan procedures, confirms the regulations do not require that the portion of coupon plan sales qualifying for installment treatment be demonstrated solely by resort to the revolving credit plan proof procedures.

B. Discrimination.

"The Commissioner cannot tax one and not tax another without some rational basis for the difference." *United States v. Kaiser*, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring). The Commissioner cannot tax Grant on sales under its coupon plan and, in the very same years, not tax Grant's competitors when there is no rational basis for the difference. *Iowa-Des Moines National Bank v. Bennett*, 284 U.S. 239 (1931) (Brandeis, J.) (revenue auditor's imposing correctly determined tax liability on bank when its competitors were incorrectly assessed lower tax held to discriminate impermissibly against bank). See *Sioux City Bridge Company v. Dakota County*, 260 U.S. 441 (1923); *Hamilton*

Nat. Bank v. District of Columbia, 156 F.2d 843 (D.C. Cir. 1946). See also *International Business Machines Corporation v. United States*, 343 F.2d 914 (Ct. Cl. 1965), *cert. denied*, 382 U.S. 1028 (1966).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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April, 1977

APPENDICES

APPENDIX A

Opinion of the United States Tax Court

UNITED STATES TAX COURT

Docket No. 1813-68.

Filed May 15, 1972.

W. T. GRANT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

The petitioner maintains a coupon book installment plan under which a book of coupons is paid for in installments, and the coupons may be exchanged for merchandise at any of the petitioner's stores. During 1964 and 1965, the petitioner also maintained plans under which certain employees were given the opportunity to purchase shares of the petitioner's stock and to pay for it over a 10-year period. Such stock was not to be issued until it was fully paid for. Before the stock was issued, the petitioner quarterly credited each participating employee's purchase account with certain net dividend credits.

Held: (1) Sales under the coupon book installment plan qualify for installment reporting under sec. 453(a), I.R.C. 1954; and

(2) The net dividend credits made by the petitioner under its employee stock purchase plans constituted compensation deductible under sec. 162(a)(1), I.R.C. 1954.

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A. CHAUNCEY NEWLIN, DAVID SACHS, and MICHAEL H. TESTA, *for the petitioner.*

POWELL W. HOLLY, JR., *for the respondent.*

SIMPSON, *Judge*: The respondent determined deficiencies in the petitioner's income tax for the taxable years ended January 31, 1964, and 1965, in the respective amounts of \$4,594,199 and \$5,376,267. Since the respondent has conceded one issue raised in the pleadings, the remaining issues for decision are: (1) Whether the petitioner's sales under its "Coupon Book Installment Plan" qualify for installment method treatment under section 453 of the Internal Revenue Code of 1954¹ and (2) whether the petitioner is entitled to deduct certain amounts credited to the accounts of its employees under its employees stock purchase plans.

FINDINGS OF FACT

Most of the facts have been stipulated, and those facts are so found.

The petitioner, W. T. Grant Company, is a corporation, incorporated in 1937 under the laws of the State of Delaware, which had its principal office and place of business in New York, New York, at the time of filing its petition in this case. It duly filed its Federal income tax returns for its taxable years ended January 31, 1964, and January 31, 1965, with the district director of internal revenue, New York, New York. A taxable or fiscal year of the

1. All statutory references are to the Internal Revenue Code of 1954, unless otherwise indicated.

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petitioner will be identified by the calendar year in which it ends.

The petitioner is engaged in the business of selling a wide variety of merchandise at retail through more than 1,000 stores located throughout the United States. For many years, the petitioner, in addition to cash sales, has made sales of merchandise under three credit plans. These credit plans are designated by the petitioner as "30-day Option Plan," which is a revolving credit plan as defined in section 1.453-2(d) of the Income Tax Regulations; "Special Purchase Installment Plan," which is a traditional installment plan as defined in section 1.453-2 of the regulations; and "Coupon Book Installment Plan." The Federal income tax treatment of the income derived under the first two of such plans is not in controversy, and it is agreed that the petitioner is a "dealer in personal property" as such term is defined in the Income Tax Regulations, section 1.453-1(a)(1).

Although the tax treatment of the special purchase installment plan is not in controversy, an explanation of the plan is helpful. Under the special purchase installment plan, a customer purchases one or more articles of merchandise and agrees in a retail credit agreement to pay for the merchandise in equal monthly installments over a certain period of time. During 1964 and 1965, such period of time varied from a minimum of 9 months under some contracts to a maximum of 25 months under others. At the time of the sale, a service charge, which is called a "time-price differential," is determined and included as part of the sales price in the agreement. The amount of the monthly payments is determined according

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to a terms table, and the payments may vary from \$5 to \$24 on sales from \$35 to \$500, respectively. Under this plan, the petitioner does not bill its customers. Rather, when he executes the credit agreement, the customer receives an installment payment card which he mails or presents monthly to the petitioner together with the appropriate monthly payment, and upon which the petitioner records the receipt of the monthly payment for the customer's records. Under this plan, the petitioner retains title to the merchandise until full payment is made.

Under the petitioner's coupon book installment plan, a customer who has established a satisfactory credit rating is issued a book of coupons, and these coupons are redeemable for merchandise. Such coupons are issued in books containing coupons in the total amounts of \$10, \$15, \$20, \$25, \$35, \$50, and \$100. Each coupon book is numbered. At the time the coupon book is issued to the customer, the customer agrees in a retail credit agreement to make payments in equal monthly installments over a fixed period of time. The fixed periods vary between a minimum and a maximum number of months. Over the years, the limits have varied between a minimum of 4 months and a maximum of 25 months, commencing with the time of issuance of the coupon book. During 1964 and 1965, the minimum period was 4 months and the maximum period was 18 months. At the time of issuance of the coupon book to the customer and execution of the agreement, the time-price differential is determined as of such date and included as a part of the selling price in the agreement. In completing the agreement upon issuance of coupons under this plan, the words "coupon book," together with the serial number of the par-

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ticular coupon book issued, are entered in the space provided for the description of the merchandise sold. The terms table used by the petitioner provides for monthly payments ranging between \$5 and \$10.

The petitioner does not bill its customers under the coupon book installment plan. Rather, the customer receives an installment payment card, identical to that used with respect to the special purchase installment plan, which he mails or presents monthly, together with the appropriate monthly payment to the petitioner, and upon which the petitioner records the receipt of the monthly payment for the customer's records. Coupons may be exchanged by the customer for merchandise at any of the petitioner's stores throughout the country, regardless of where such coupons are issued.

The retail credit agreements used under the coupon book installment plan are identical in most States to those utilized under the special purchase installment plan and provide that the petitioner retains title to the merchandise sold thereunder until full payment is made. In New York, California, Delaware, and Oregon, State law does not permit title retention where merchandise is sold in exchange for coupons, and the form of retail credit agreement used in such States omits such a provision. Under both plans, the customer may pay installments in advance if he so desires, but such anticipation of the payments does not reduce the amount to be paid on each monthly payment due after the due dates of the prepaid payments; the customer may prepay the full balance due under the retail credit agreement, in that event, he receives a proportional refund credit of part of the time-price differential as required by applicable

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State law; a customer may return merchandise or unused coupons, in that event, the amount due under the retail credit agreement and the time-price differential will be appropriately reduced; and a customer may enter into a new retail credit agreement before the final installment under a prior agreement is due, in that event, the new agreement will incorporate the prior balance due and will include a new time-price differential determined at the time of signing the new agreement with reference to the new principal amount thereunder.

The petitioner records its sales under both the special purchase installment plan and the coupon book installment plan on the same forms and does not distinguish between the two plans for bookkeeping and accounting purposes. It maintains a ledger history card for each credit customer and posts sales of merchandise or issuance of coupons to such customer on such card. The same chapter in the petitioner's credit manual describes the petitioner's office procedures in handling sales under both plans.

Since each coupon book is numbered, it is identifiable to a particular installment contract. However, due to the enormous volume of coupons exchanged for merchandise, the petitioner does not identify and record the exchange of each coupon by account. Each store prepares a report for each business day for monthly submission to the petitioner's central accounting department showing the aggregate dollar value information relative to coupons issued and finance charges, coupons exchanged for merchandise, and payments received on installment contracts. The petitioner's central accounting department then accounts for all such transactions as follows:

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ACCOUNTING FOR COUPONS ISSUED

(Credit)	Accounts receivable	(Balance sheet)
(Credit)	Unredeemed credit coupons	(Balance sheet)
(Credit)	Finance charge income	(Profit and Loss)

ACCOUNTING FOR COUPONS EXCHANGED FOR MERCHANDISE

(Debit)	Unredeemed credit coupons	(Balance sheet)
(Credit)	Sales	(Profit and Loss)

ACCOUNTING FOR PAYMENTS RECEIVED ON INSTALLMENT CONTRACTS

(Debit)	Cash	(Balance sheet)
(Credit)	Accounts receivable	(Balance sheet)

ACCOUNTING FOR COST OF MERCHANDISE

Petitioner's accounting department records the cost of merchandise for which coupons are exchanged as follows:

(Debit)	Cost of goods sold	(Profit and Loss)
(Debit)	Inventory	(Balance sheet)

In computing its gross profit for Federal income tax purposes, the petitioner reduces the gross profit on its books by what it refers to as "unrealized gross profit" for the year. Unrealized gross profit for the year is computed by (1) subtracting from the amount in the accounts receivable at the end of the year, the amount of unredeemed coupons at that same time and multiplying the figure so obtained by the applicable gross profit margin; and (2) subtracting from the resulting figure in (1) the figure arrived at by multiplying the accounts receivable as of the

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beginning of the year, less the unredeemed coupons at that time, by the applicable gross profit margin.

In the years 1964 and 1965, the coupons were issued and redeemed as follows:

	Year Ending 1/31/64		Year Ending 1/31/65	
	Issued	Exchanged	Issued	Exchanged
February	\$ 1,460,871	\$ 1,504,519	\$ 1,952,444	\$ 2,035,461
March	2,626,412	2,418,166	4,135,066	4,028,201
April	3,751,915	3,848,494	2,925,694	2,965,132
May	3,434,443	3,292,301	3,666,574	3,663,209
June	3,715,722	3,685,273	3,570,298	3,556,715
July	2,867,400	2,867,848	2,997,056	2,925,674
August	5,443,084	5,014,733	6,142,581	5,471,999
September	3,473,033	3,658,764	4,663,402	4,743,474
October	3,723,560	3,494,843	5,354,656	4,687,125
November	8,973,515	7,017,936	12,001,386	9,002,065
December	15,271,699	17,118,059	18,275,381	20,954,723
January	1,224,398	1,743,482	1,386,167	2,206,531
	<u>\$55,966,052</u>	<u>\$55,664,418</u>	<u>\$67,070,705</u>	<u>\$66,240,309</u>

The balance in the unredeemed coupon account at the end of 1964 was \$1,033,971, and at the end of 1965, was \$1,864,367. Thus, the amounts of coupons exchanged for merchandise in those years equalled 99.46 percent and 98.76 percent, respectively, of the amounts of coupons issued during such years.

Under date of July 1, 1969, the petitioner received a letter from an attorney in the Division of Supervision and Regulation of the Board of Governors of the Federal Reserve System, Washington, D. C., in which it was stated that the coupon plan was not an open-end credit plan.

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In its Federal income tax returns for all years since the adoption of the coupon book installment plan in 1947, the petitioner has elected to report its gross profit on sales thereunder by using the installment method pursuant to section 453(a) and its predecessor, section 44(a) of the Internal Revenue Code of 1939.

In the notice of deficiency, the respondent determined that the sales made under the coupon book installment plan do not qualify for installment treatment "as traditional installment sales under the provisions of section 453(a) . . . and the regulations thereunder."

Throughout 1964 and 1965, the petitioner maintained an "Employees Stock Purchase Plan," which had been adopted in 1960 (the 1960 plan), and which had succeeded a plan that had been in effect since 1950 (the 1950 plan). In all relevant aspects, the two plans are alike, and both are involved in the petitioner's taxable years 1964 and 1965, since stock purchase contracts under each plan were outstanding in those years. The purpose of the 1950 plan was:

to provide an additional inducement for officers and employees to promote the best interests of the Company and its stockholders. This purpose is sought to be accomplished by affording an opportunity to certain officers and employees of the Company (herein referred to as "employees"), who are in a position to contribute materially to its prosperity, to purchase shares of its Common Stock on a deferred payment basis, and thereby to acquire a proprietary interest in the Company. For this purpose, and without in any way affecting the amount of their compensation or the terms of their employment, the em-

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employees designated are granted the privilege of purchasing shares of the Company's Common Stock under the terms and conditions set forth in the Plan.

The purpose set forth in the 1960 plan was not materially different. During the years 1964 and 1965, over 2,000 employees were offered stock, and over 300,000 shares were under contract.

The plans were administered by a committee which was composed of nonparticipating members of the petitioner's board of directors and which adopted the administrative regulations governing the operations of the plans. The regulations and committee action identified employees entitled to participate and the amounts of stock they were entitled to purchase. In no event could an employee purchase stock in an amount and on such terms that the then unpaid balance of the purchase price owed by him with respect to all stock purchased under the plan exceeded the highest compensation paid or payable to him for any fiscal year.

Although the stock offered to employees could be either unissued stock or treasury stock, no treasury stock was available for this purpose throughout the petitioner's taxable years 1964 and 1965, and all offers of unissued stock were made pursuant to a prospectus. The stock, which had a par value of \$2.50 per share, was offered to employees at a price fixed by a formula designed to arrive at a figure which was approximately its fair market value at the time that the employee accepted the offer, as shown by transactions on the New York Stock Exchange where such stock is listed.

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An employee who received an offer was given 2 years (later reduced to 22 months and then to 11 months) to accept it, in whole or in part, at any time and from time to time. Upon electing to purchase, the employee executed a purchase contract and made a downpayment of \$1 per share. He was expected to pay annually a minimum of 5 percent of the balance, and to pay the full balance within 10 years. If the employee failed to make his final payment on the purchase price, the petitioner was empowered to "issue and sell" any undelivered shares which the employee was purchasing and apply the net proceeds against his account and pay over to him any surplus.

With respect to the stock not paid for in full, the plan provided that:

Cash dividends as such will not accrue * * *. However, on dividend payment dates a participating employee who is then actively employed by the Company will receive a credit in an amount equal to dividends paid by the Company with respect to the number of shares of stock purchased by the employee but not yet fully paid for and deliverable to him. Such dividend credit will be charged with interest on the unpaid balance of the purchase price at such annual rate as is prescribed by the Committee at the time the particular Purchase Contract is executed, which rate shall be not less than 2% per annum. The dividend credit, less interest charge, shall be applied against the purchase price * * *.

Certificates for shares contracted for under the 1950 and 1960 plans were not issued to the purchaser at the time of the making of the contract, and were only issued in blocks of 10 shares, as such amount of stock was fully paid for.

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Until the stock was so issued, an employee had no voting rights with respect to such stock.

An employee's rights under the plan or under a purchase contract were not assignable, except that an employee could name a beneficiary who, in the event of the employee's death, would succeed to certain rights under a purchase contract. An employee could not sell shares purchased by him under the plan without first offering such shares to the company at their then market price.

If an employee ceased to be employed for any reason, he could not thereafter accept any pending offering of stock under the plans, and all dividend credits and interest charges ceased to accrue. In cases other than death, disability, or retirement, he could, within 30 days after termination of employment, pay the balance of the purchase price and obtain delivery of all shares then subject to a purchase contract. If he did not do so, the company, at its election, could cancel the contract, and if it did so, it was required to repay to the former employee the amount theretofore paid by him, including net dividend credits on the purchase price of shares not fully paid for and delivered to him. An employee was thereby assured of always receiving, in cash or in stock, an amount equal to the net dividend credits.

In the event of the death of a participating employee, his estate or his designated beneficiary, if any, succeeded to his rights (except that dividend credits ceased to accrue), and the balance due could be paid in 6 months. If the balance was not so paid, the company cancelled the unpaid balance and returned all payments, including net dividend credits

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theretofore made on the purchase price of shares not fully paid for and delivered to the deceased employee.

If a participating employee retired or became disabled, thereafter he could not accept pending offers, and he was not entitled to further dividend credits. Under contracts dated before May 1, 1954, he was otherwise treated as continuing in the employ of the company for purposes of completing payments under existing stock purchase contracts, and under contracts dated thereafter, he was so treated for 2 years.

In the event of stock dividends or stock split-ups with respect to the company's common stock, the number of shares then being offered to employees or which were then covered by outstanding purchase contracts was to be proportionately increased. If the petitioner offered subscription rights to its common stockholders, each participating employee had the right to subscribe for such securities as he would be entitled to subscribe for if he were then the record holder of the number of shares of common stock which were then the subject of outstanding purchase contracts entered into by him. At the employee's election, the securities which he would be entitled to subscribe for could be purchased by him under the same terms as existed in his most recent purchase contract. Employees did not have the right to sell or assign any such subscription rights.

Each plan provided that it could be terminated prior to the termination date stated therein by action of the board of directors of the petitioner, but such termination would not affect the right of employees to complete payment for stock which was then the subject of a purchase contract.

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With respect to each participating employee, the petitioner, for each quarter, recorded on its books an amount equal to the quarterly dividend rate times the number of undelivered shares in the participating employee's account, less the applicable interest rate on the total unpaid balance. This "net dividend credit" was entered as a credit against the unpaid purchase price of stock subject to contract, and charged to profit and loss as an expense. For the petitioner's taxable years 1964 and 1965, the aggregate of credits equal to dividends were \$519,817 and \$544,194, and the aggregate of interest charges were \$280,962 and \$297,777, resulting in net dividend credits, respectively, of \$238,855 and \$246,417. The petitioner deducted such net dividend credits as "Salaries and Wages" in its Federal income tax returns for those years.

The petitioner did not withhold Federal income tax from employees participating in the employees stock purchase plan during the taxable years 1964 and 1965 with respect to the net dividend credits added to the accounts of participants during those years. However, the petitioner has filed, with respect to each participating employee, a Form W-2 reporting as compensation the net dividend credit added to the account of the participating employee. It has also sent to each participating employee a copy of W-2 and an annual letter advising him that for income tax purposes "this amount [the net dividend credit] must be reported by you as additional salary and not as dividends since dividends are not declared or paid on unissued shares of stock."

In an amendment to his answer, the respondent alleged that the net dividend credits were not deductible as compensation, but were in fact charges against surplus.

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OPINION

The first issue to be decided is whether the petitioner's sales under its coupon book installment plan qualify for installment method treatment under section 453.

Section 453(a)(1) provides:

Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

Section 1.453-2(b)(1), Income Tax Regulations, in relevant part provides:

The term "sale on the installment plan" means—

(1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property, which plan, by its terms and conditions, contemplates that each sale under the plan will be paid for in two or more payments, * * *

The respondent contends that the coupon book installment plan does not meet the requirements of this regulation. It is his position that under the plan there are separate transactions entered into by the customer: In the first transaction, the customer purchases a coupon book agreeing to pay for it over a period of time. In separate transactions, he purchases merchandise in one of the petitioner's stores by exchanging coupons therefor, without the execution of any further agreement regarding the particular item of

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merchandise purchased. Thus, the respondent argues that the monthly payments made by the customer are not specifically attributable to the purchase of any item of merchandise, that one payment may represent the sum of prices paid for several items, and that therefore it cannot be concluded that each sale of merchandise through a redemption of coupons is paid for in two or more installments.

On the other hand, the petitioner contends that the coupon plan is an installment plan because it contemplates the purchase of an aggregate of items of merchandise, of a predetermined amount, which is to be paid for in two or more installments. It is, thus, the petitioner's position that the payments made by the customers are not for the coupons, which have no intrinsic worth, but are for the merchandise, and that the coupons merely allow the customer to get delivery of such merchandise. The petitioner argues that in substance the coupon book installment plan is merely an arrangement permitting customers to purchase a number of items of merchandise and to pay for them in installments, and that to the extent that installments are not paid during the taxable year, it is entitled to defer a portion of the profits on the sales until a later year under section 453.

An example of the petitioner's treatment of sales under the coupon book installment plan will be helpful in understanding the issues in this case: Assume that a customer purchased a coupon book, containing \$100 worth of coupons, and executed a retail installment contract agreeing to pay \$110 for the book in installments. During the year, the customer paid 4 installments, totaling \$40, of the purchase price of the book and exchanged \$80 worth of coupons. The petitioner's cost of goods sold and other

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expenses attributable to the sales were \$54, and its gross profit ratio for the year was 40 percent.

At the time of the sale of the coupon book and the execution of the retail credit agreement, the petitioner would establish an account receivable of \$110. The payments received during the year would be credited to that account so that at the end of the year it stood at \$70. When the account receivable was established, the \$10 finance charge would be includable in income, and as the coupons were redeemed, they would be recorded as income so that during the year, the petitioner would record \$90 as income. At the end of the year, the petitioner's books would show \$36, or 40 percent of \$90, as the profit from these transactions. To compute its gross unrealized profit for the year due to these transactions, the petitioner would subtract from the \$70 in the account receivable at the end of the year, the amount of the unredeemed coupons, or \$20. The balance, or \$50, would be multiplied by the gross profit ratio of 40 percent, resulting in an unrealized gross profit due to these sales of \$20. This amount is deferred under the petitioner's method of accounting, with the result that \$16, or \$36 less \$20, remains in the petitioner's income for the year. The \$16 represents 40 percent of the \$40 in payments that were actually received during the year.

If the customer had redeemed only \$40 worth of coupons during the year, then \$50 would have been includable in the petitioner's income—\$40 worth of sales and \$10 finance charge, and it would exclude only \$4 of unrealized gross profit—40 percent of the \$10 finance charge which has not yet been collected by the petitioner. It would report as profit \$16, or 40 percent of the \$40 received during the year.

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Since 1926, the tax laws have allowed dealers in personal property to elect to report their profits on installment sales by use of the installment method described in section 453(a). The Supreme Court stated in *Commissioner v. South Texas Co.*, 333 U.S. 496, 503 (1948):

The installment basis of reporting was enacted, as shown by its history, to relieve taxpayers who adopted it from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact they had *received in cash* only a small portion of the sale price. * * * [Emphasis supplied.]

See *Burnet v. S. & L. Bldg. Corp.*, 288 U.S. 406, 413, (1933); *Everett Pozzi*, 49 T.C. 119 (1967); *Thomas F. Prendergast, Executor*, 22 B.T.A. 1259, 1262 (1931). In construing section 453, it is our responsibility to attempt to carry out that purpose. See *Blum's, Incorporated*, 7 B.T.A. 737, 758 (1927).

Section 453 refers to "sales on the installment plan" without any special definition of the term, and therefore, we should construe it in the light of the generally accepted meaning of such term. *Consolidated Dry Goods Company v. United States*, 180 F. Supp. 878 (D. Mass. 1960); see also *Bingham v. Commissioner*, 105 F. 2d 971 (C.A. 2, 1939). Finney and Miller, *Principles of Accounting—Advanced* (5th ed. 1960), p. 104, says "[a]n installment sale is a sales arrangement whereby the selling price is collected in *periodical installments*." (Emphasis supplied.) Webster's New International Dictionary (3d ed. 1968) contains the following definition of "installment selling": "the selling

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of consumer goods on credit under conditional sales contracts that provide for regular periodic payments after an initial down payment."

Although the petitioner's credit manual recognizes the possibility that a coupon book may be paid for in cash, the parties have stipulated that the purchase agreements executed in 1964 and 1965 provided for from 4 to 18 payments. Moreover, even if a coupon book is sold for cash, there is no debit to accounts receivable and consequently no deferral of income. Thus, any cash sales are clearly segregated, and we are only concerned with those sales that were paid for in installments.

Apparently, merchandise certificates, such as the coupons used by the petitioner, are widely used in making credit sales. The National Conference of Commissioners on Uniform State Laws said, in connection with the Uniform Consumer Credit Code (§ 2.105):

"Merchandise certificate" primarily means the kind of Scrip issued by merchants to facilitate the purchase on credit of a number of relatively small items so that a separate contract or agreement is not required for each item purchased * * *.

A number of the State statutes regulating credit sales recognize that merchandise certificates are commonly used in connection with such sales. See, e.g., California Civil Code governing retail installment sales, sec. 1802.1; Delaware Retail Installment Sales Law (6 Del. C. Ann. Supp. 1970), sec. 4301; Kansas Sales Finance Act, chapter 16-502(a).

It is clear to us that when a customer of the petitioner purchases a coupon book, he is doing so in order to acquire

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an aggregate of merchandise and to pay for it in installments. By purchasing the book of coupons, the customer can obtain the desired merchandise at that time, or shortly thereafter, while paying for it in installments over a number of months, perhaps as many as 18. The coupons have no intrinsic value; there is no reason for the customer to purchase them, except as a step toward purchasing the merchandise on credit. If the customer merely wished to make several small purchases and pay for them at the time, there would be no need for him to purchase a coupon book and to incur the added finance charge. Moreover, the data concerning the issuance and redemption of coupons in 1964 and 1965 suggests that most of the coupons are redeemed shortly after they are issued. It would be utterly uneconomical for the petitioner to enter into a special installment sales contract with respect to each small sale of merchandise. The coupon book is a practicable method to permit customers to purchase an aggregate of small items of merchandise on credit. In our opinion, the sales under such plan come within the general concept of installment sales.

Furthermore, we think that the petitioner is entitled to treat sales under its coupon book installment plan as installment sales under section 453. The section was enacted so that the tax could be paid "from the proceeds collected rather than be advanced by the taxpayer." *Thomas F. Prendergast, Executor, supra* at 1262. When the petitioner makes sales under such plan, part of the purchase price is not collected until a later year. If the petitioner cannot use the installment method for reporting the gain on such sales, it will be taxable on the entire gain

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in the year of sale, even though the purchase price is to be paid in installments, some of which will not be received until a later year; thus, the petitioner would, in effect, have to "advance the tax." As the example illustrates, the petitioner's method of treating sales under its coupon book installment plan results in the petitioner reporting the portion of the payments that it receives during the year and deferring the profit attributable to the installments to be received in a later year. Under the petitioner's method, no deferral is claimed except with respect to those sales which are paid for in installments, some of which are to be received in a later year; and an adjustment is made to exclude from consideration the unredeemed coupons representing sales not yet completed. The fact that the installment payments are not traced to particular sales of merchandise does not prevent the petitioner from achieving the proper accounting treatment of the sales under the coupon book installment plan. In addition, since a coupon book is an arrangement to purchase an aggregate of merchandise which is paid for in installments, the "two or more payment rule" of section 453 is also satisfied, regardless of when a particular item of merchandise is selected and the sale thereof is completed. Thus, we conclude and hold that the sales under such plan qualify for installment method treatment under section 453.

Our conclusion is quite consistent with the regulations under section 453. All sales under the coupon book installment plan, with which we are concerned, are paid for in installments, and consequently, they all meet the test set out in section 1.453-2(b) of the regulations. The technical objections raised by the respondent in this case are similar to those that he presented in *Consolidated Dry*

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Goods Company v. United States, supra. There he argued that revolving credit sales should not qualify for installment method treatment because there is not a separate installment contract executed with respect to each sale, and because the payments cannot be identified or traced to a particular sale of merchandise. The court there rejected such arguments on the ground that the absence of such conditions did not prevent the revolving credit sales from qualifying as installment sales within the general meaning of that term.

After that decision, the Treasury regulations were amended to recognize that certain revolving credit sales could qualify as installment sales, despite the respondent's prior technical objections. Sec. 1.453-2(d), Income Tax Regs. Similarly, in 1964, Congress also recognized that revolving credit sales could qualify under section 453. Thus, both the Treasury and the Congress now recognize that revolving credit sales can qualify under section 453, even though there is no separate installment contract for each sale, and each payment is not traceable to a particular sale of merchandise. Likewise, the absence of such conditions does not prevent the petitioner's sales under its coupon book installment plan from qualifying under section 453.

The respondent seems to contend that the regulations relating to revolving credit plans narrowed the scope of *Consolidated Dry Goods Company v. United States, supra*; that such narrowing was approved by Congress, and that therefore Congress did not intend that plans such as the coupon book installment plan qualify for section 453 treatment. However, under a revolving credit plan, a customer makes purchases during a billing period and has the option of paying for all or part of his purchases at the end of such

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period. If he pays for all his purchases at the end of the period, there is no finance charge; the goods have been paid for in one payment, and the purpose for applying section 453 is not present. However, if the customer elects to pay only a portion of his bill and defer payment of the remainder thereof, the purpose for applying section 453 is present. *Consolidated Dry Goods* held that an entire revolving credit plan qualified for installment reporting even though it was possible that not all the customers under the plan used the deferred payment option. When the regulations were amended to provide for revolving credit plans, the deferral of income under such plans was limited to income arising out of sales involving more than one payment. The regulations provided a method for differentiating between such sales and sales involving just one payment. Sec. 1.453-2(d), Income Tax Regs. On February 26, 1964, Congress enacted section 453(e) which provided that:

(e) Revolving Credit Type Plans.—For purposes of subsection (a), the term "installment plan" includes a revolving credit type plan which provides that the purchaser of personal property at retail may pay for such property in a series of periodic payments of an agreed portion of the amounts due the seller under the plan, except that such term does not include any such plan with respect to a purchaser who uses his account primarily as an ordinary charge account. [Act of Feb. 26, 1964, Pub. L. 88-272, 78 Stat. 19, 75.]

In August 1964, Congress repealed the provision that it had enacted in February, and Mr. Mills said:

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It was concluded that because of the variation in revolving credit type plans, it was better to leave to regulation—which could provide the necessary flexibility—the extent to which sales under revolving credit type plans are to be treated as sales under installment plans. [110 Cong. Rec. 20302 (1964).]

See H. Rept. No. 1290, to accompany the Act of Aug. 31, 1964 (Pub. L. 88-539), 88th Cong., 2d Sess., p. 4-5; Act of August 31, 1964, Pub. L. 88-539, 78 Stat. 746. It is apparent from this brief review of the treatment of revolving credit plans that both Congress and the Treasury were basically concerned with differentiating between sales involving one payment and those involving more than one payment and that the holding of *Consolidated Dry Goods* has, except as to that point, been accepted by the Congress and the Treasury. Since we have found that the coupon book installment plan involves two or more payments, there is no indication that Congress intended to exclude this type of plan from the scope of section 453.

The second issue for decision is whether the net dividend credits under the petitioner's employee stock purchase plan constituted compensation which was deductible under section 162. As the respondent raised this issue by means of an amended answer, he has the burden of proof on the issue. Rule 32, Tax Court Rules of Practice; *Texas Pipe Line Co.*, 32 B.T.A. 125 (1935), *affd.* 87 F. 2d 662 (C.A. 3, 1937), *cert. denied* 302 U.S. 706 (1937). The respondent contends that when an employee executed a purchase contract under one of the petitioner's plans, he became the beneficial owner of the shares contracted for and that the credits were, therefore, dividends. The respondent further contends that even if the credits were

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not dividends, they were a nondeductible distribution of surplus because the stock purchase plans were essentially designed, not to provide for compensation, but to provide certain employees with the opportunity to acquire a proprietary interest in the company. The petitioner contends that the stock being acquired under the plans did not constitute issued stock until it was paid for and delivered to the employees and that under Delaware law, the petitioner could not legally pay dividends on such unissued stock. The petitioner concludes that the net dividend credits cannot be considered to be dividends and that such credits constituted reasonable compensation paid by it to the participating employees.

In determining whether the employee became a stockholder at the time he signed the agreement, we must interpret the purchase contract in accordance with Delaware law. See *United States Steel Corporation*, 2 T.C. 430, 437 (1943) (where this Court held certain dividend credits which were paid under an employee stock purchase plan to be deductible compensation). After a careful consideration of Delaware law, we have concluded that the question of whether there has been a subscription to stock, which results in conferring the status of stockholder upon the subscriber as of the date of the subscription, is a question which depends upon the terms of the agreement and the intention of the parties. *Louisiana Oil Exploration Co. v. Raskob*, 32 Del. 564, 127 Atl. 713 (Super. Ct. 1925). It appears further that an agreement to purchase stock upon a deferred payment plan conferred such a status upon a purchaser only where the contract did not set forth conditions precedent to the assumption by the purchaser of such status. See *Hegarty v. American Commonwealths Power*

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Corp., 20 Del. Ch. 231, 174 Atl. 273 (1934); *Pasotti v. United States Guardian Corporation*, 18 Del. Ch. 1, 156 Atl. 255 (1931).

Having examined the evidence before this Court regarding the terms of the agreements and the intentions of the parties to those agreements, we have concluded that the petitioner's employees did not become stockholders upon the execution of the stock purchase contracts. Rather, they became stockholders only when the shares were paid for and issued in blocks of 10, as provided for in the plans. We think it clear that this was the intention of the parties. The agreements specifically provided that shares should be delivered to employees only as paid for in full and only in blocks of 10. Prior to the delivery, the employees had no voting rights and no interests as stockholders which could be assigned. Furthermore, the net dividend credit applied only so long as an employee remained in the petitioner's employ. For instance, in the case of a retired employee, the net dividend credit was no longer accruable even though the retired employee continued to pay for stock on the deferred basis.

It follows, and we conclude, that since the employees became stockholders only when shares were issued to them in blocks of 10, the net dividend credits made to their accounts prior thereto did not constitute dividends. Rather, we think it clear from the plans and the agreements that it was the intention of the parties that the net dividend credits should constitute additional compensation. *Thurman v. Studebaker Corporation*, 88 F. 2d 984 (C.A. 7, 1937); *United States Steel Corporation*, *supra*; *Electric Storage Battery Co.*, 39 B.T.A. 121 (1939). The plans stated that the purpose was to provide an additional inducement for officers

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and employees to promote the best interests of the company and its stockholders (the 1960 plan used the word "incentive"). Furthermore, the net dividend credits were made only so long as an employee continued in the employ of the petitioner.

The respondent points to language contained in the plans to the effect that the employees designated are granted the privilege of purchasing the shares "without in any way affecting the amount of their compensation or the terms of their employment," and argues that this indicates that the intention was only to permit the purchase of stock, and not to provide compensation under the plans. We think, however, that the purpose of this language was to make certain that the purchase of the stock under the terms of the plans should not affect the regular compensation of the employees. We consider the net dividend credits as additional compensation. In this connection, it should be observed that the respondent does not contend that, if the net dividend credits are held to be additional compensation, the compensation paid to the employees is unreasonable in amount within the meaning of section 162(a)(1). Nor does the respondent contend that, if the credits constitute additional compensation, they are not deductible in the years they are made and become nonforfeitable.

In view of the foregoing considerations, it is our conclusion that the petitioner properly deducted the net dividend credits as compensation in the years such credits were made
Reviewed by the Court.

Decision will be entered under Rule 50.

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ATKINS, J., dissenting: I respectfully dissent from the holding of the majority that all sales under petitioner's coupon book installment plan qualify for installment reporting treatment under section 453(a) of the Internal Revenue Code of 1954.

As pointed out by the majority, section 453(a) contains no specific definition of the term "sale on the installment plan." However, the regulations promulgated pursuant thereto do contain a detailed definition of what is meant by that term. Section 1.453-2(b) of the Income Tax Regulations provides as follows:

(b) *Definition of sale on the installment plan.*

The term "sale on the installment plan" means—

(1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property which plan, by its terms and conditions, contemplates that each sale under the plan will be paid for in two or more payments, or

(2) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property—

(i) Which plan, by its terms and conditions, contemplates that such sale will be paid for in two or more payments, and

(ii) Which sale is in fact paid for in two or more payments.

Normally, a sale under a traditional installment plan (as described in paragraph (a) (1) of section 1.453-1), meets the requirements of subparagraph (1) of this paragraph. See paragraph (d) of this section for the application of the requirements of subparagraph (2) of this paragraph to sales under revolving credit plans.

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The majority relies upon the case of *Consolidated Dry Goods Company v. United States* (D. Mass., 1960), 180 F. Supp. 878, for the proposition that since the statute contains no definition of the term "sale on the installment plan" such term should be construed in the light of the generally accepted meaning of such term. In that case the Court held that a revolving credit plan came within the ordinary meaning and accepted trade meaning of the term "installment plan," and that therefore sales under such plan qualified for installment reporting. However, as pointed out by the Court, the statute and the then applicable regulations contained no express definition of the term "installment plan."

Thereafter, on October 15, 1963, the respondent promulgated new regulations containing the above quoted provisions and provided for installment plan treatment of certain amounts received under revolving credit plans. See T.D. 6682, 1963-2 C.B. 197. However, the respondent in such regulations did not accept in its entirety the holding of the Court in the *Consolidated Dry Goods* case. Revolving credit plans fall only within the second definition contained in the above regulations, and the regulations require that it be proved which sales are in fact paid for in two or more installments. A method was provided for determining what percentage of revolving credit accounts meets this requirement. The above regulations have been subjected to Congressional scrutiny and the approach taken by the respondent has been approved by Congress.¹

¹ By section 222 of the Revenue Act of 1964 (enacted February 26, 1964), Congress amended section 453 of the Code by adding a subsection providing that the term "installment plan" includes a revolving credit plan. However, by Pub. L. 88-539 (enacted August 31, 1964), Congress repealed such provision retroactively as of its initial effective

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In view of the foregoing, it seems to me that the *Consolidated Dry Goods* case is of little help here. It also seems clear to me that, unless the above quoted regulations are to be disregarded, resort to general definitions of the term "sale on the installment plan" is beside the point. Nor are the provisions of state law with regard to coupons and coupon sales helpful in deciding what is a "sale on the installment plan" for Federal income tax purposes. I, of course, recognize the relief purpose for enactment of the installment method of reporting income as pointed out by the majority, but it is still incumbent upon petitioner to show

date. With regard to such repeal, it was stated in S. Rept. No. 1242, 88th Cong., 2d Sess., 1964-2 C.B. 696 at 699:

Revolving credit-type plans.—Prior to October 15, 1963, sales under revolving credit type plans were not recognized by the Treasury Department as installment sales for tax purposes because of certain differences between revolving credit plans and traditional installment plans.

Traditional installment plans (described in regulations sec. 1.453-2(b)(1)) ordinarily involve a separate contract for each item of property purchased, providing for a series of payments specifically applicable to the purchase price of that property. Usually the seller also retains some type of security interest in the property until the property is paid for. Revolving credit type plans (described in regulations sec. 1.453-2(b)(2)) on the other hand usually do not involve separate sales contracts. Under these plans, any item in the store may be charged to the same account and the seller does not retain any security interest in the property sold. The buyer frequently has the option to pay his account in full within 30 days with no finance charges or he may pay the account in installments with periodic finance charges related to the unpaid balances of the account. In this latter case, the buyer's regular payments are not specifically attributable to the purchase price of any single item but instead go to reduce the unpaid balance on what may be the total price of several items purchased at different times.

New regulations were issued by the Treasury Department on October 15, 1963 (T.D. 6682) specifically providing for installment sale treatment of certain amounts received under revolving credit plans. Broadly speaking, under these rules, a sample

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that it qualifies for the relief under the statute and regulations.

It is clear that the plan here involved calls for the payment for coupons in installments. However, the petitioner does not contend, nor does the majority hold, that this is itself a sale of merchandise upon the installment plan within the meaning of section 453(a). Translating this into sales of merchandise under an installment plan is another matter and I cannot agree with the majority.

I agree that this plan generally is intended to facilitate the purchase of a number of relatively small items of mer-

of revolving credit sales is taken from balances in customer accounts as of the billing dates for the last month of the seller's taxable year and the percentage of sales in the sample accounts determined which: (1) are the type the revolving credit plan contemplates will be paid for in two or more installments and (2) actually are paid for in two or more installments. The percentage is then applied to the balances of the total revolving credit accounts (after adjusting for sales of nonpersonal property) and the resulting amount is treated as representing sales under the installment plan.

In the Revenue Act of 1964, Congress in effect replaced these regulations with a provision providing that the term installment plan was to include a revolving credit type plan, except that the term was not to include any such plan with respect to a purchaser who uses it primarily as an ordinary charge account.

Your committee has concluded that it would have been better to have left the Treasury Department with the opportunity to determine by regulation the extent to which sales under revolving credit type plans are to be treated as sales under installment plans. For that reason, it has repealed the provision added in this respect by the Revenue Act of 1964 (subsec. (e) of sec. 453 as added by sec. 222 of the Revenue Act of 1964). In taking this action, your committee intends that the term "sales on the installment plan" be interpreted by the regulations as covering "sales on a revolving credit type plan" to the full extent provided in the regulations issued by the Treasury Department on October 15, 1963 (T.D. 6682). However, it is anticipated that continuing efforts will be made to simplify the sampling procedures required by those regulations as experience makes this possible.

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chandise with the customer paying therefor by the installments provided for the payment for the coupon book itself. And it is apparently the case that most customers redeem their coupons shortly after issuance so that the installments payable for the coupon book are in fact payable for the merchandise purchased. However, there is no showing that this is always so.

Under the petitioner's accounting system, and under the majority's holding, a sale does not take place until the customer exchanges coupons for merchandise. It is these sales all of which are held to be "sales on the installment plan." Such conclusion is not in accord with the applicable regulations.

As pointed out above, section 1.453-2(b) sets forth two definitions of the term "sale on the installment plan." The majority focuses only on the first definition and does not take into consideration the second definition. The language of the two definitions is inartful at best and at first reading it may appear that the two definitions are both referring to the same thing. But obviously they contemplate two different situations which are to be distinguished from each other.

The second definition refers to a sale under a plan which plan contemplates that such sale will be paid for in two or more payments and which sale is in fact paid for in two or more payments. As an example of this the regulations refer to sales under a revolving credit plan.² It seems to me that

² Although the reason for the adoption of the definitions contained in section 1.453-2(b) and of the other sections of the regulations promulgated in T.D. 6682 may have been to deal specifically with the problem of sales under revolving credit type plans, there is nothing which would indicate that the second definition in section 1.453-2(b) is limited to sales under such plans. Rather, I view the second definition as being applicable to sales under any plan not coming within the first definition.

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this definition requires two things: first, an examination of a particular sale to see if that sale, under the terms of the plan under which it took place, may be paid for in two or more payments; and second, an after-the-fact determination as to whether or not that particular sale was in fact paid for in two or more payments. Distinguished from this is the first definition which states that a sale on the installment plan is a sale under a plan which plan contemplates that *each* sale under the plan will be paid for in two or more payments. As an example of this the regulations refer to a traditional installment sale. It will be noted that this definition does not at all look to what in fact happens. It looks solely to the plan itself. I think it is clear that this means that the plan must be such that by its terms and conditions there can be no sale thereunder which is to be paid for in less than two payments. If this is not so, the second definition, which looks to what in fact happens, would be meaningless.

Viewed in this light, I do not think that petitioner's coupon book installment plan is a plan under which there can be no sales paid for in less than two payments. As pointed out above, a sale under the plan does not take place until the customer redeems a coupon or coupons for merchandise. A customer might buy merchandise in an amount that has theretofore been completely paid for by the installments provided under the retail credit agreement; or a customer might buy merchandise in an amount for which there is only one remaining installment due; or a customer might buy merchandise each month only in an amount which is covered by the next installment due under the retail credit agreement. These illustrations establish that there can be sales under petitioner's plan which can be paid for in less than two payments. The fact that the examples cited may

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rarely take place in fact is irrelevant. We are concerned initially only with whether under the literal terms of the plan there can ever be sales which will be paid for in less than two payments. Accordingly, the sales under petitioner's plan fail to qualify under the first definition, namely, that contained in section 1.453-2(b)(1).

However, petitioner's coupon book installment plan does contemplate that there will be sales which can be paid for in two or more payments. Accordingly, any sale which is in fact paid for in two or more payments will qualify for installment reporting pursuant to the provisions of section 1.453-2(b)(2) of the regulations.

The concern is only with those sales as to which a portion of the profit is being deferred from one taxable year to another. The amount of profit deferred is the profit reflected in the accounts receivable outstanding as of the end of the year. Under petitioner's accounting system when coupon books are sold the amount due thereon is included in accounts receivable. However, as payments are made on such coupon books the accounts receivable are appropriately reduced. Hence, any sales made by the exchange of coupons which have already been paid for do not enter into the problem here presented since accounts receivable have been reduced by such payments and the profit on such sales is included in taxable income for the year. As of the end of the year the amount of unredeemed coupons is deducted from the amount of accounts receivable, so that the accounts receivable as of that time, as so reduced, reflect only consummated sales the profit on which petitioner has deferred.

I think it is apparent that any sales made prior to the last month of petitioner's taxable year for which petitioner has deferred any profit were paid for in two or more installments, since the installments on the coupon books

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sales are paid monthly. In such cases there would have been a payment in the last month of the taxable year and at least one payment in the subsequent year. Accordingly, I would hold that the petitioner properly deferred the reporting of profit on such sales.

A different situation is presented with respect to sales made in the last month of each taxable year. It may be that all or substantially all such sales are paid for in two or more installments, but this the petitioner has not shown. Indeed, since petitioner does not identify and record the exchange of each coupon by reference to each coupon book account, it would not be possible to determine which of such sales were paid for in two or more installments. It is quite possible that some of such sales were not paid for in two or more installments. For example, during the last month of the year a customer may have purchased goods by using a coupon with respect to which there is but one remaining installment due, namely, the installment due to be paid after the end of the year. Or during the last month of the year a customer might purchase goods by use of a coupon with respect to which there is more than one installment due to be paid after the end of the year, but the customer elects to prepay such installments in one payment so that in fact there is but one payment after the purchase of the merchandise. In such cases, it could not be considered that the purchase price was paid in two or more installments, as contemplated by section 1.453-2(b)(2) of the regulations.

Under the circumstances I would hold that the reporting of profit on sales made under this plan in the last month of each of the petitioner's taxable years in question may not be deferred.

HOYT, J., agrees with this dissent.

APPENDIX B

**Opinion of the United States
Court of Appeals for the Second Circuit**
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 770—September Term, 1972.
(Argued May 10, 1973 Decided August 22, 1973.)
Docket No. 72-2213

W. T. GRANT COMPANY,

Appellee,

v.

COMMISSIONER OF INTERNAL REVENUE

Appellant.

Before: SMITH, MULLIGAN and TIMBERS, *Circuit Judges.*

Appeal by the Commissioner of Internal Revenue from decision of Tax Court, Charles R. Simpson, *Judge*, reviewed by the court, 58 T.C. 290 (1972), that taxpayer's sales under Coupon Book Installment Plan qualify for installment method treatment under § 453, Internal Revenue Code of 1954.

Reversed.

*Opinion of the
United States Court of Appeals for the Second Circuit*

JANE M. EDMISTEN, Attorney, Tax Division, Department of Justice (Scott P. Crampton, Asst. Attorney General, Meyer Rothwacks and Paul M. Ginsburg, Attorneys, Tax Division, Department of Justice, Washington, D.C., of counsel), *for Appellant.*

A. CHAUNCEY NEWLIN, New York, N.Y. (White & Case, New York, N.Y., David Sachs, of counsel), *for Appellee.*

SMITH, *Circuit Judge:*

The Commissioner of Internal Revenue appeals from a decision of the Tax Court, Charles R. Simpson, *Judge*, reviewed by the court, reported at 58 T.C. 290 (1972), holding that taxpayer's sales under its Coupon Book Installment Plan qualify for installment method treatment under § 453 of the Internal Revenue Code of 1954. We find that the sales do not qualify under the Code¹ and the regulations² and reverse.

1. Internal Revenue Code of 1954 (26 U.S.C.):

"SEC. 453. INSTALLMENT METHOD.

(a) [as amended by Sec. 3(a), Act of August 31, 1964, P.L. 88-539, 78 Stat. 746] *Dealers in Personal Property.*—

(1) In general.—Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price."

2. Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

"§ 1.453-1 *Installment method of reporting income.*

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United States Court of Appeals for the Second Circuit*

The facts are found in the Tax Court opinion and may be summarized as follows.

Grant's provides its customers with three basic credit plans: (a) Special Purchase Installment Plan, a traditional single item installment plan; (b) 30-day Option Plan, a typical revolving credit plan; and (c) the Coupon Book Installment Plan, the plan at issue. Under the Special Purchase Installment Plan the customer enters into a retail credit agreement for individual purchases, and agrees to pay equal monthly installments over a fixed period of time. A service charge is included as part of the selling price. For the term of the contract, Grant's retains a security interest in the item purchased.

(a) In general. (1) Section 453 permits dealers in personal property, that is, persons who regularly sell or otherwise dispose of personal property on the installment plan, to elect to return the income from the sale or other disposition thereof on the installment method. To the extent provided in paragraph (d) of § 1.453-2, sales under a revolving credit type plan will be treated as sales on the installment plan and the income from the sales so treated may be returned on the installment method. A dealer who makes sales of personal property under both a revolving credit plan and a traditional installment plan may elect to report only sales under the traditional installment plan on the installment method; or he may elect to report only sales under the revolving credit plan on the installment method; or he may elect to report both sales under the revolving credit plan and the traditional installment plan on the installment method. A traditional installment plan usually has the following characteristics:

(i) The execution of a separate installment contract for each sale of personal property, and

(ii) The retention by the dealer of some type of security interest in such property.

(2) The installment method may also be applied with certain limitations (see paragraph (c) of this section) to the sale or other disposition of real property and the casual sale or other casual disposition of certain personal property.

*Opinion of the
United States Court of Appeals for the Second Circuit*

The 30-Day Option Plan allows a customer, through use of a credit card, to charge to his account sales during the billing month which he may pay fully within thirty days without a service charge, or may elect to pay at least 10 per cent of the balance in the account each month. With this election the customer incurs a service charge calculated each month on the outstanding balance in the account. No security interest is retained in the merchandise.

Under the Coupon Book Installment Plan customers deemed good credit risks are given the opportunity to purchase coupon books whose coupons may be redeemed for merchandise in any Grant's store. The books vary in value from \$10 to \$100 and contain coupons of various denominations.³ The books may be paid for in full or over

§ 1.453-2 Special rules applicable to dealers in personal property.

* * * * *

(b) *Definition of sale on the installment plan.* The term "sale on the installment plan" means—

(1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property, which plan, by its terms and conditions, contemplates that each sale under the plan will be paid for in two or more payments, or

(2) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property—

(i) Which plan, by its terms and conditions, contemplates that such sale will be paid for in two or more payments, and

(ii) Which sale is in fact paid for in two or more payments. Normally, a sale under a traditional installment plan (as described in paragraph (a)(1) of § 1.453-1) meets the requirements of subparagraph (1) of this paragraph. See paragraph (d) of this section for the application of the requirements of subparagraph (2) of this paragraph to sales under revolving credit plans."

3. For instance in a \$50 book, coupons range from \$2.00 to 50¢ in value.

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United States Court of Appeals for the Second Circuit*

a period of time pursuant to a retail credit agreement in which the customer agrees to pay a certain time price differential in addition to prescribed monthly payments. In the tax years in question the period was a minimum of four months, a maximum of eighteen months. During this period the coupons may be redeemed at any time and in any amount. Return of the coupons or merchandise, or payment in full of the outstanding balance of the obligation results in a reduction in the amount due, as well as a proportionate reduction in the time price differential.⁴

Grant's accounts for the special purchase plan sales and coupon books redemption in an identical manner. Sales under the coupon plan are deemed to occur when the coupons are redeemed, not when the coupon books are initially sold. The retail credit agreement, however, does indicate that the book is the item sold on which credit is extended. Grant's does not keep records of coupon redemption for each customer account. Thus there is no means of correlating the sales of merchandise items to the installment payments.

The Tax Court found that the coupon book was an installment sale, a "sales arrangement whereby the selling

4. Grant's relies in part on a letter from the Treasury indicating that it was not an open-ended credit plan for the purposes of the Truth in Lending Act.

This does not settle the issue for § 453 purposes. The purpose of the Truth in Lending Act is to assure that the consumer debtor is aware fully of the costs of his credit. Where the cost is predetermined and spelled out in advance the special disclosures required for open-ended accounts are not needed. Whether payments under a credit plan are made on a revolving credit plan under § 453 goes to an entirely different issue—whether in fact payments on a debt account covering the purchase of a number of items covers the purchase price of particular purchases, or represents only partial payment of the price of each item, justifying tax deferral.

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price is collected in periodical installments" and "the selling of consumer goods on credit under conditional sales contracts that provided for regular periodic payments after an initial down payment." The court resorted to the "common understanding of installment sale" as was done in *Consolidated Dry Goods Co. v. United States*, 180 F. Supp. 878 (D. Mass. 1960). In *Consolidated Dry Goods*, however, this was resorted to solely for lack of either a statutory or regulatory definition of installment sale. Regulatory definitions were quickly drawn up in response to *Consolidated Dry Goods*. Congress in 1964 first adopted, but soon repealed a statutory definition, preferring to rely on the regulation. See 1964 U.S. Code Cong. & Admin. News 3320, S. Rep. No. 1242, 88th Cong., 2d Sess. Any determination, therefore, of Grant's qualifying for §453 treatment must be made in the context of the regulations. §1.453-2(b) (1), (2).

Traditional installment sales, as characterized in §453 (1)(a) are covered by Treas. Reg. § 1.453-2(b)(1). Normally under these plans a separate contract is executed for each sale of personal property, and a security interest is retained in the property. Typical of such sales is the conditional sales contract. Sales falling within the second definition, § 1.453-2(b)(2) include—contingent on certain proof⁵—revolving credit plans, cycle budget accounts, flexible budget accounts, and other similar plans or arrangements for the sale of personal property under which the customer agrees to pay each billing month a part of the outstanding balance of his account.

5. Treas. Reg. § 1.453-2(d)(3).

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Installment reporting was enacted as a relief provision to allow a merchant first to actually realize profits arising from deferred payment transactions before requiring that a tax be paid on the gain. *Prendergast v. Commissioner*, 22 BTA 1259, 1262 (1931). To qualify for the benefits of installment reporting the taxpayer has the obligation of showing that he is one of the intended beneficiaries of §453, that in fact gain realized on his sales will be received in installments.

The primary distinction between § 1.453-2(b)(1) and § 1.453-2(b)(2) sales on installment plans focuses on this obligation of the taxpayer. Where there is a separate contract for each sale in which the parties contract for installment payments for the purchase of a particular item, the Commissioner will accept the provision for periodic payments as establishing such payments. Where, however, the parties' contract covers a number of sales no specific intent is demonstrated as to any particular purchase; it is not unlikely then that while installment payments may be made on a great number of the sales, some will be paid in single payments. As intent cannot be demonstrated specifically proof of actual multiple payments is required. See S. Rep. No. 1242, *supra*, at 3320-22; Emory, *The Installment Method of Reporting Income: Its Election, Use and Effect*, 53 Cornell L. Rev. 181, 262-63 (1968).

The Congress, in the Revenue Act of 1964, as noted above, initially adopted the position suggested by the Tax Court here, and provided a statutory definition of installment sale so as to extend §453 "to income received under any plan which provides for the payment by the purchaser for per-

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sonal property sold to him in a series of periodic installments of an agreed part or installment of the debt due the seller." Exception was made for sales essentially made as an ordinary charge account. See 1964 U.S. Code Cong. & Admin. News at 1771-72. Within the same year, however, the statutory definition was repealed, the Congress concluding "that it would have been better to have left the Treasury Department with the opportunity to determine by regulation the extent to which sales under revolving credit type plans are to be treated as sales under installment plans." S. Rep. No. 1242, *supra*, at 3322.

In the context of the regulation's definitions the similarities between the Special Purchase Installment Plan and the Coupon Book Installment Plan relied on by the Tax Court and appellee are of little significance. While the company uses the same accounting procedures for both plans, the basic distinction still exists—contract and accounts under the special purchase plan apply to a single sale item and thus reflect an intent as to the specific purchase and clearly correlate payments to individual sales while there is no correlation of payment and purchase under the coupon book plan.⁶

6. Traditionally a conditional sales contract retained a security interest in the property because the usual sale was of hard goods which would have some resale value on repossession. Generally items bought on a revolving credit plan would not be subject to this kind of security interest because such soft goods would have relatively little resale value after repossession. Raum, *The Tax Aspects of Revolving Credit: Application of the Installment Method of Reporting Income*, 19 Institute of Federal Taxation 1225, 1226 (1961). In some states retention of such an interest is prohibited for revolving credit including merchandising coupons. See, e.g., N.Y. Personal Property Law § § 401, 402A (McKinney, 1962), as amended (McKinney Supp. 1972).

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Underlying the court's decision in the case at bar was the assumption that when a customer purchases a coupon book he is doing so in order to acquire an aggregate purchase of merchandise and to pay for it in installments. It discounted the possibility of small individual purchases that would be covered by the monthly payments, or delayed redemptions, finding it unreasonable to believe that customers would incur an added finance charge without taking advantage of the extension of credit. Yet while it is true that overall the records of the company indicate that a great number of the coupons are redeemed quickly and frequently in a period of one month, there is evidence that a significant number are not immediately redeemed.⁷

The evidence suggests the possibility that redemptions could be covered by single or prior payments. The proof procedures provided in §1.453-2(d) were designed to cover this situation—sales where a large number are expected to be paid and are paid in installments,⁸ but may also be and are in some cases paid in full⁹. The intent of Congress is clear; §453 is to be extended to revolving credit plans, such as Grant's subject however to the regulation and proof requirements deemed warranted by the Commissioner. At least some and possibly a substantial number of the purchases in the last month of the tax year are covered by a single month's payment and were not intended to be the basis for tax deferral.

7. In both 1964 and 1965, issued coupons exceeded redeemed coupons in six months of each year, ranging from \$140,000 to \$1,960,000 in 1964 and \$3,000 to \$3,000,000 in 1965.

8. The regulations were deemed at the time of the 1964 Revenue Act to cover at least 80% of all revolving credit plans.

9. The possibility of single payments to avoid incurring a credit charge under revolving credit plans apparently is one basis for the Commissioner's insistence on some proof provision under § 453.

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Grant's chose the merchandising coupons method to avoid the expense and inefficiency of a separate credit contract for each small purchase; in doing so it lost the protection of the traditional installment sales presumption of periodic payment.¹⁰

"A dealer who desires to compute income by the installment method shall maintain accounting records in such a manner as to enable an accurate computation to be made by such a method in accordance with the provisions of this section. . . ." Treas. Reg. §1.453-2(c)(1). Grant's might either have used separate contracts or kept customer accounts of redemptions. It did neither and therefore cannot prove that it is eligible for §453 relief. Tax deferral should not have been granted.

Reversed and remanded.

10. The government contends that under Grant's accounting methods, if installment tax treatment is allowed, a substantial amount received over the years for coupons mislaid, lost or destroyed will never be reached for taxation. We express no opinion on the substantiality of this claim on the record before us.

APPENDIX C

Memorandum and Order

UNITED STATES TAX COURT

Docket No. 1813-68

W. T. GRANT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MEMORANDUM AND ORDER

The petitioner, on June 20, 1974, filed a motion for a further trial to afford it an opportunity to introduce evidence it claimed was made relevant and necessary in view of the decision of the United States Court of Appeals for the Second Circuit (483 F. 2d 1115 (1973)), which reversed and remanded our decision for the petitioner (58 T.C. 290 (1972)). Two hearings have been held on this motion which is opposed by the Commissioner.

In our prior opinion, we held that the petitioner's sales under its coupon book installment plan qualified for installment method treatment under section 453 of the Internal Revenue Code of 1954. In reversing and remanding our decision, the Court of Appeals said: "Grant's might either have used separate contracts or kept customer accounts of redemptions." 483 F. 2d at 1119. The parties admitted that Grant failed to keep separate contracts and could not qualify for use of the installment method by showing that each sale was made on the basis of that method. The Court of Appeals considered the method used by Grant as a type of revolving credit sale. It reviewed the legislative history as to what sales made under the revolving credit method

Memorandum and Order

should qualify for installment method reporting and concluded that Congress left to Treasury to define the qualifying sales in its regulations. Admittedly, the Grant sales could not meet the tests set forth in the Treasury regulations. See section 1.453-2(d), Income Tax Regs.

The petitioner now seeks to introduce new evidence to show what portion of the coupons are immediately redeemed. It asserts that this evidence will show that a high percentage of the coupon sales result in installment sales. The petitioner agrees that its sales cannot meet the tests now set forth in the regulations to qualify revolving credit sales. We have urged the parties to confer and suggested that the regulations be re-examined to determine whether those tests should be broadened so as to include the types of sales made by Grant. However, the Commissioner has refused to modify his regulations or to qualify the Grant sales.

It is clear to us that the new evidence which Grant seeks to introduce will not qualify the plan for installment reporting in light of the Court of Appeals decision. It held that a revolving credit plan, to qualify under section 453, must satisfy the requirement of section 1.453-2(d) of the regulations. The petitioner concedes it cannot satisfy these regulations since it kept no individual customer accounts of redemptions, but contends that the evidence it seeks to offer would be equivalent to the test provided in the regulations. However, the Court of Appeals decision requires that the regulations be satisfied. A further trial to hear this new evidence would thus accomplish no purpose. Accordingly, it is

ORDERED: That the petitioner's motion for further trial is denied.

/s/ CHARLES R. SIMPSON
Judge

Dated: Washington, D. C.
March 21, 1975

OrderUNITED STATES TAX COURT
WASHINGTON

Docket No. 1813-68

W. T. GRANT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

*Respondent.***ORDER**

On April 11, 1975, the petitioner filed a motion for reconsideration and review by the full Court of petitioner's motion for further trial filed June 20, 1974. Two hearings were held on the petitioner's motion for further trial; the parties were encouraged to attempt to settle the matter by negotiation; and the motion was given extensive consideration by this Court. After due deliberation, Judge Simpson denied the motion, and in accordance with the customary procedures of this Court, there was no reason for referring the matter to Chief Judge Dawson for his consideration or for reference to the full Court for review. Accordingly, no further purpose would be served by any additional consideration of the petitioner's motion by this Court at this time, and it is

ORDERED: That such motion for reconsideration and review by the full Court of petitioner's motion for further trial is hereby denied.

/s/ HOWARD A. DAWSON, JR.
Chief Judge

/s/ CHARLES R. SIMPSON
Judge

Dated: Washington, D.C.
April 15, 1975

DecisionUNITED STATES TAX COURT
WASHINGTON

Docket No. 1813-68

W. T. GRANT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

*Respondent.***DECISION**

Pursuant to the opinion and mandate of the United States Court of Appeals for the Second Circuit, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That the following statement shows the petitioner's income tax liabilities for the taxable years ending January 31, 1964 and January 31, 1965:

TAXABLE YEAR ENDING JANUARY 31, 1964

Deficiency, without taking into consideration the assessment subsequent to the mailing of the deficiency notice on February 23, 1968	\$3,208,867.00
Assessment, December 25, 1972 (paid)	435,081.00
Deficiency (to be assessed)	<u>\$2,773,786.00</u>

Decision

TAXABLE YEAR ENDING JANUARY 31, 1965

Deficiency, without taking into consideration the assessment subsequent to the mailing of the deficiency notice on February 23, 1968	\$3,744,552.00
Assessment, December 25, 1972 (paid)	408,051.00
Deficiency (to be assessed)	<u>\$3,336,501.00</u>

(Signed) CHARLES R. SIMPSON
Judge

Entered: June 17, 1975

APPENDIX D

**Opinion of the United States Court
of Appeals for the Second Circuit**

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 424 — September Term, 1976
(Argued January 13, 1977 Decided February 3, 1977)
Docket No. 75-4214

CHARLES G. RODMAN, as Trustee of the
ESTATE OF W. T. GRANT COMPANY, Bankrupt,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Before: KAUFMAN, *Chief Judge,*
SMITH and MULLIGAN, *Circuit Judges.*

Appeal from decision of Tax Court of the United States, Charles R. Simpson, Judge, assessing deficiencies in accordance with this court's decision in *W. T. Grant Co. v. Commissioner*, 483 F.2d 1115 (2d Cir. 1973). Affirmed.

MARTIN D. GINSBURG (Weil, Gotshal & Manges, New York, N.Y., Harvey R. Miller, Peter Gruenberger, Harvey S. Berenson, Kenneth H. Heitner and Irwin H. Warren, of counsel), *for Appellant.*

*Opinion of the
United States Court of Appeals for the Second Circuit*

JONATHAN S. COHEN, Attorney, Tax Division, Dept. of Justice (Myron C. Baum, Acting Assistant Attorney General, Gilbert E. Andrews and Joseph L. Liegl, Attorneys, Tax Division, Dept. of Justice, Washington, D. C., of counsel), for Appellee.

SMITH, Circuit Judge:

Charles G. Rodman ("Rodman"), Trustee in bankruptcy of the Estate of W.T. Grant Company ("Grant"), appeals from a decision of the Tax Court, Charles R. Simpson, Judge, denying motion for further trial and entering judgment on computation in accordance with this court's opinion in *W.T. Grant Co. v. Commissioner*, 483 F.2d 1115 (2d Cir. 1973), rehearing *en banc* denied; cert. denied, 416 U.S. 937 (1974). Appellant alleges that our prior decision rests on an erroneous legal analysis. He cites the intervening bankruptcy of Grant in April 1976, the advent of new counsel, and a substantial increase in the amount in controversy in later tax years as further grounds for reconsideration. We find no error in the analysis in our previous decision in this case and find none of the other factors advanced by appellant a compelling ground for departing from the law of the case doctrine. We affirm.

The facts and proceedings of this case have been summarized in our prior opinion, *id.* at 1116. On June 17, 1975, following remand from this court, the Tax Court assessed tax deficiencies against Grant for the years 1964 and 1965 of \$2,773,786 and \$3,336,501 respectively. This assessment was based on our holding that Grant could not report income from sales of merchandise under its coupon credit plan on the installment method provided in § 453 of the

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Internal Revenue Code of 1954 and Treasury Regulations issued thereunder because Grant had failed to maintain records of sales required to prove the extent to which such sales were actually paid for in installments.¹ Grant sought

1. Section 453 of the Internal Revenue Code and applicable Regulations provide in relevant part as follows:

Internal Revenue Code of 1954 (26 U.S.C.):

§ 453. Installment method.

(1) In general.—Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

Treasury Regulations on Income Tax (26 C.F.R.):

§ 1.453-1 *Installment method of reporting income.*

(a) In general. (1) Section 453 permits dealers in personal property, that is, persons who regularly sell or otherwise dispose of personal property on the installment plan, to elect to return the income from the sale or other disposition thereof on the installment method. To the extent provided in paragraph (d) of § 1.453-2, sales under a revolving credit type plan will be treated as sales on the installment plan and the income from the sales so treated may be returned on the installment method. . . . A traditional installment plan usually has the following characteristics:

- (i) The execution of a separate installment contract for each sale of personal property, and
- (ii) The retention by the dealer of some type of security interest in such property.

§ 1.453-2

(b) *Definition of sale on the installment plan.* The term "sale on the installment plan" means—

(1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property, which plan, by its terms and conditions, contemplates

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United States Court of Appeals for the Second Circuit*

a new trial in the Tax Court following remand. The Tax Court denied Grant's motion because it found that the new evidence sought to be introduced would not qualify the Grant coupon plan for installment reporting in the light of our earlier holding and assessed the deficiency.² This appeal followed.

Once a rule of law has been established for a case we will not depart therefrom on a subsequent appeal unless special circumstances of the case warrant a reopening of issues previously decided. *United States v. Fernandez*, 506 F.2d 1200, 1203-04 (2d Cir. 1974); *Zdanok v. Glidden Co., Durkee Famous Foods*, 327 F.2d 944 (2d Cir. 1964). We find no circumstances in the case at bar which require a departure from the law of the case doctrine. Neither the intervening bankruptcy and the alleged resulting hardship to creditors nor the increased use of the coupon credit plan by Grant after 1965 with resulting increased tax liabilities consti-

that each sale under the plan will be paid for in two or more payments, or

(2) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property—

(i) Which plan, by its terms and conditions, contemplates that such sale will be paid for in two or more payments, and

(ii) Which sale is in fact paid for in two or more payments.

Normally, a sale under a traditional installment plan (as described in paragraph (a)(1) of this section), meets the requirements of subparagraph (1) of this paragraph. See paragraph (d) of this section for the application of the requirements of subparagraph (2) of this paragraph to sales under revolving credit plans.

2. Tax Court Order, March 21, 1975; Tax Court Decision, June 17, 1975.

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tutes a change in circumstances which, in the interest of justice, requires reconsideration of legal issues already decided on sufficient grounds. It may be noted that Grant and its creditors have been on notice since 1973, three years before the bankruptcy, that the coupon credit plan would not receive installment tax treatment in the absence of adequate records.

The Internal Revenue Code and Regulations issued thereunder permit installment reporting of income from sales under "traditional installment plans" meeting the definition of § 1.453-2(b)(1). They permit installment reporting of income under other, non-traditional installment plans only if records are kept, pursuant to § 1.453-2(d)(3), which establish whether or not a particular purchase was in fact paid for in two or more installments. Appellant Rodman concedes that Grant did not keep records required under § 1.453-2(d)(3), and that its coupon plan does not qualify as a traditional plan under § 1.453-2(b)(1). He argues that Grant's plan, although qualifying as a non-traditional installment plan under § 1.453-2(b)(2), is not a "revolving credit type plan" and hence not covered by § 1.453-2(d). Rodman contends that special ad hoc record-keeping requirements should be permitted for the Grant plan.

Appellant now claims that our previous decision, holding § 1.453-2(d) applicable to the Grant coupon plan, rested on an erroneous characterization of Grant's coupon plan as a "revolving credit plan." We disagree. Treasury Regulation § 1.453-2(d), entitled "Revolving credit plans," covers "cycle budget accounts, flexible budget accounts . . . and other similar plans . . . for the sale of personal property. . ." The common feature of all such plans, shared by the Grant coupon plan, is that it is impossible to determine whether any particular sale is in fact paid for in two or more install-

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ments unless records for each sale are kept. A customer purchasing an item on the coupon plan could, for example, prepay the entire outstanding balance in a single payment, or such a customer could make one or more small purchases, all of which would be completely paid for by a single installment payment on the coupon plan. Under such non-traditional credit plans a percentage of charges may not be treated as installment sales, unless a taxpayer maintains records pursuant to Treas. Reg. §§1.453-2(d)(2), (3) which enable him to determine on the basis of a sample analysis, what percentage of sales are eligible for installment plan tax treatment. No such records were kept by appellant.

The previous decision of this court, denying installment tax treatment to the Grant coupon plan, rests on the specific characteristics of the Grant plan, in particular the inability under that plan to prove that sales were actually paid for in installments.

The proof procedures provided in § 1.453-2(d) were designed to cover this situation—sales where a large number are expected to be paid and are paid in installments, but may also be and are in some cases paid in full.

Id. at 1119. The fact that the plan was referred to as a "revolving credit plan" by this court was irrelevant to the basis of our decision which rested on the particular features of the plan, not on reference to it as a revolving credit plan. We held that the record-keeping requirements of §1.453-2(d) were applicable to the Grant plan. The relevant issues were considered by this court on the first appeal based on undisputed facts and the applicable law.³ No

3. Rodman now seeks to introduce evidence concerning treatment of other comparable credit plans by the IRS in support of his argument on appeal. We may not consider such evidence first offered at this stage.

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material error is now pointed out in the facts then before the court or the law applied. We adhere to the ruling on the first appeal.

Affirmed.

Judgment

**UNITED STATES COURT OF APPEALS
SECOND CIRCUIT**

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the third day of February one thousand nine hundred and seventy-seven.

Present: Hon. IRVING R. KAUFMAN, *Chief Judge*,
Hon. J. JOSEPH SMITH,
Hon. WILLIAM H. MULLIGAN, *Circuit Judges*.

75-4214

CHARLES G. RODMAN, Trustee of the Estate of
W. T. GRANT COMPANY, Bankrupt,
Petitioner-Appellant,
v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeals from The Tax Court of the United States.

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the petitioner-appellant.

Filed Feb. 3, 1977

A. DANIEL FUSARO,
Clerk

by: VINCENT A. CARLIN,
Chief Deputy Clerk

APPENDIX E

**INTERNAL REVENUE CODE
of 1954**

Sec. 453 (a) DEALERS IN PERSONAL PROPERTY.

(1) **IN GENERAL.**—Under regulations prescribed by the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) **TOTAL CONTRACT PRICE.**—For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan or with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1).

Sec. 453 (e) CARRYING CHARGES NOT INCLUDED IN TOTAL CONTRACT PRICE.

If the carrying charges or interest with respect to sales of personal property, the income from which is returned under subsection (a)(1), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest. This subsection shall not apply with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in subsection (a)(1).

APPENDIX F

TREASURY REGULATIONS

§ 1.453-1. Installment method of reporting income.--(a)

In General. (1) Section 453 permits dealers in personal property, that is, persons who regularly sell or otherwise dispose of personal property on the installment plan, to elect to return the income from the sale or other disposition thereof on the installment method. To the extent provided in paragraph (d) of § 1.453-2, sales under a revolving credit type plan will be treated as sales on the installment plan and the income from the sales so treated may be returned on the installment method. A dealer who makes sales of personal property under both a revolving credit plan and a traditional installment plan may elect to report only sales under the traditional installment plan on the installment method; or he may elect to report only sales under the revolving credit plan on the installment method; or he may elect to report both sales under the revolving credit plan and the traditional installment plan on the installment method. A traditional installment plan usually has the following characteristics:

(i) The execution of a separate installment contract for each sale of personal property, and

(ii) The retention by the dealer of some type of security interest in such property.

(2) The installment method may also be applied with certain limitations (see paragraph (c) of this section) to the sale or other disposition of real property and the casual sale or other casual disposition of certain personal property.

(b) *Income to be reported.* (1) Persons permitted to use the installment method of accounting prescribed in section

Appendix F

453 may return as income from installment sales in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when the property is paid for bears to the total contract price. In the case of dealers in personal property, for this purpose, gross profit means sales less cost of goods sold. See § 1.453-2 for rules applicable to the computation of income of dealers in personal property reporting on the installment method. In the case of sales of real estate and casual sales of personal property, gross profit means the selling price less the adjusted basis as defined in section 1011 and the regulations thereunder. Gross profit, in the case of a sale of real estate by a person other than a dealer and a casual sale of personal property, is reduced by commissions and other selling expenses for purposes of determining the proportion of installment payments returnable as income. For rules applicable in determining "selling price" and the use of certain other terms, see also paragraph (c) of § 1.453-4.

(2) For purposes of section 453, any total unstated interest (as defined in section 483(b)) under a contract for the sale or exchange of property, payments on account of which are subject to the application of section 483, shall not be included as a part of the selling price or the total contract price. For rules relating to payments received prior to January 1, 1964, see paragraph (a)(2) of § 1.483-2.

(3) For purposes of section 453, any amount of original issue discount in respect of certain corporate obligations issued after May 27, 1969, as computed pursuant to paragraph (b)(2)(iii) of § 1.1232-3 (relating to obligations issued in exchange for property) shall not be included as part of the selling price or the total contract price.

*Appendix F**(c) Limitations on the use of the installment method.*

(1) Income from the sale or other disposition of real property or from casual sales or other casual dispositions of personal property may be reported on the installment method for taxable years beginning after December 31, 1953, only if, in the taxable year of the sale or other disposition, (i) there are no payments or (ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(2) The income from a casual sale or other casual disposition of personal property may be reported on the installment method only if (i) the property is not of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, and (ii) its sale price exceeds \$1,000.

(3) See § 1.453-3 for the treatment of purchaser evidences of indebtedness that are payable on demand or readily tradable.

(4) Income shall be computed and reported separately for each casual sale or other casual disposition of personal property as installment payments are received in the year of sale and subsequent years.

(d) Treatment of gain or loss on default by the purchaser of personal property sold on the installment plan. If for any reason the purchaser defaults in any of his installment payments, and the vendor (whether he is a dealer in personal property or a person who has made a casual sale or other casual disposition of personalty), returning income on the installment method, repossesses the property sold, whether title thereto had been retained by the vendor or transferred to the purchaser, gain or loss for the year in which the repossession occurs is to be computed upon any

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installment obligations of the purchaser which are satisfied or discharged upon the repossession or are applied by the vendor to the purchase or bid price of the property. Such gain or loss is to be measured by the difference between the fair market value at the date of repossession of the property repossessed and the basis in the hands of the vendor of the obligations of the purchaser which are so satisfied, discharged, or applied, with property adjustment for any other amounts realized or costs incurred in connection with the repossession. (See also § 1.453-6.) The basis in the hands of the vendor of the obligations of the purchaser satisfied, discharged, or applied upon the repossession of the property shall be the excess of the face value of such obligations over an amount equal to the income which would be returnable were the obligations paid in full. For definition of the basis of an installment obligation, see section 453(d)(2) and paragraph (b)(2) of § 1.453-9. No deduction for a bad debt shall in any case be taken on account of any portion of the obligations of the purchaser which are treated by the vendor as not having been satisfied, discharged, or applied upon the repossession unless it is clearly shown that after the property was repossessed the purchaser remained liable for such portion; and in no event shall the amount of the deduction exceed the basis in the hands of the vendor of the portion of the obligations with respect to which the purchaser remained liable after the repossession. See also section 166 and the regulations thereunder.) If the property repossessed is bid in by the vendor at a lawful public auction or judicial sale, the fair market value of the property shall be presumed to be the purchase or bid price thereof in the absence of clear and convincing proof to the contrary. The fair market value of the property repossessed shall be reflected

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in the appropriate permanent records of the vendor at the time of such repossession.

(e) *Other accounting methods.* If the vendor chooses as a matter of consistent practice to return the income from installment sales on an accrual method or on the cash receipts and disbursements method, such a course is permissible.

(f) *Records.* In adopting the installment method of accounting the seller must maintain such records as are necessary to clearly reflect income in accordance with this section, section 446 and § 1.446-1.

§ 1.453-2. SPECIAL RULES APPLICABLE TO DEALERS IN PERSONAL PROPERTY.—(a) *In general.* A person who regularly sells personal property on the installment plan may adopt (but is not required to do so) one of the following four ways of protecting his interest in case of default by the purchaser:

(1) By an agreement that title is to remain in the vendor until the purchaser has completely performed his part of the transaction;

(2) By a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the selling price;

(3) By a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the vendor; or

(4) By conveyance to a trustee pending performance of the contract and subject to its provisions.

(b) *Definition of sale on the installment plan.* The term "sale on the installment plan" means—

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(1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property which plan, by its terms and conditions, contemplates that each sale under the plan will be paid for in two or more payments, or

(2) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property—

(i) Which plan, by its terms and conditions, contemplates that such sale will be paid for in two or more payments, and

(ii) Which sale is in fact paid for in two or more payments.

Normally, a sale under a traditional installment plan (as described in paragraph (a)(1) of this section), meets the requirements of subparagraph (1) of this paragraph. See paragraph (d) of this section for the application of the requirements of subparagraph (2) of this paragraph to sales under revolving credit plans.

(c) *Installment income of dealers in personal property—*

(1) *In general.* The income from sales on the installment plan of a dealer, that is, a person regularly engaged in the sale of personal property on the installment plan, may be ascertained by treating as income that proportion of the total payments received in the taxable year from sales on the installment plan (such payments being allocated to the year against the sales of which they apply) which the gross profit realized or to be realized on the total sales on the installment plan made during each year bears to the total contract price of all such sales made during that respective year. However, if the dealer demonstrates to the satisfac-

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tion of the district director that income from sales on the installment plan is clearly reflected, the income from such sales may be ascertained by treating as income that proportion of the total payments received in the taxable year from sales on the installment plan (such payments being allocated to the year against the sales of which they apply) which either (i) the gross profit realized or to be realized on the total credit sales made during each year bears to the total contract price of all credit sales during that respective year, or (ii) the gross profit realized or to be realized on all sales made during each year bears to the total contract price of all sales made during that respective year. See, however, paragraph (d)(6)(vi) of this section for rules permitting, under certain circumstances, all sales under a revolving credit plan to be considered as having been made in the taxable year. A dealer who desires to compute income by the installment method shall maintain accounting records in such a manner as to enable an accurate computation to be made by such method in accordance with the provisions of this section, section 446, and § 1.446-1.

(2) *Gross profit and total contract price.* For purposes of subparagraph (1) of this paragraph, in computing the gross profit realized or to be realized on the total sales on the installment plan, there shall be included in the total selling price and, thus, in the total contract price of all such sales,

(i) The amount of carrying charges or interest which is determined at the time of each sale and is added to the established cash selling price of such property and is treated as part of the selling price for customer billing purposes, and

(ii) In the case of sales made in taxable years beginning on or after January 1, 1960, the amount of carrying charges

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or interest determined with respect to such sales which are added contemporaneously with the sale on the books of account of the seller but are treated as periodic service charges for customer billing purposes.

Any change in the amount of the carrying charges or interest in a year subsequent to the sale will not affect the computation of the gross profit for the year of sale but will be taken into account at the time the carrying charges or interest are adjusted. However, this subparagraph does not apply to sales of personal property under a revolving credit plan described in paragraph (d)(1) of this section, nor to sales described in section 453(b)(1) and paragraph (c) of § 1.453-1. The application of this subparagraph to carrying charges or interest described in subdivision (ii) of this subparagraph may be illustrated by the following example:

Example. X Corporation makes sales on the traditional installment plan. The customer's order specifies that the total price consists of a cash price plus a "time price differential" of 1½ percent per month on the outstanding balance in his account and he is billed in this manner. On its books and for purposes of reporting to stockholders, X Corporation consistently makes the following entries each month when it records its sales. A debit entry is made to accounts receivable (for the total price) and balancing credit entries are made to sales (for the established selling price) and to a reserve account for collection expense (for the amount of the time price differential). In computing the gross profit realized or to be realized on the total sales on the installment plan, the total selling price and, thus, the total contract price for purposes of this paragraph would, with respect to sales made in taxable years beginning on or after January 1, 1960, include the time price differential.

*Appendix F**(3) Carrying charges not included in total contract price.*

In the case of sales by dealers in personal property made during taxable years beginning after December 31, 1963, the income from which is returned on the installment method, if the carrying charges or interest with respect to such sales is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest. For application of this rule to revolving credit sales, see paragraph (d)(6)(v) of this section.

(d) *Revolving credit plans.* (1) To the extent provided in this paragraph, sales under a revolving credit plan will be treated as sales on the installment plan. The term "revolving credit plan" includes cycle budget accounts, flexible budget accounts, continuous budget accounts, and other similar plans or arrangements for the sale of personal property under which the customer agrees to pay each billing-month (as defined in subparagraph (6)(iii) of this paragraph) a part of the outstanding balance of his account. Sales under a revolving credit plan do not constitute sales on the installment plan merely by reason of the fact that the total debt at the end of a billing-month is paid in installments. The terms and conditions of a revolving credit plan do not contemplate that each sale under the plan will be paid for in two or more payments and thus do not meet the requirements of paragraph (b)(1) of this section. In addition, since under a revolving credit plan payments are not generally applied to liquidate any particular sale, and since the terms and conditions of such plan contemplate that account balances may be paid in full or in installments, it is generally impossible to determine that a particular sale under a revolving credit plan is to be or is in fact paid for in installments so as to meet the requirements of paragraph (b)(2) of this section. However, subparagraphs (2) and

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(3) of this paragraph provide rules under which a certain percentage of charges under a revolving credit plan will be treated as sales on the installment plan. For purposes of arriving at this percentage, these rules, in general, treat as sales on the installment plan those sales under a revolving credit plan (1) which are of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments and (2) which are charged to accounts on which subsequent payments indicate that such sales are being paid for in two or more installments.

(2)(i) The percentage of charges under a revolving credit plan which will be treated as sales on the installment plan shall be computed by making an actual segregation of charges in a probability sample of the revolving credit accounts and by applying the rules contained in subparagraph (3) of this paragraph to determine what percentage of charges in the sample is to be treated as sales on the installment plan. (See subparagraph (5) of this paragraph for rules to be used if some of the sales under a revolving credit plan are nonpersonal property sales (as defined in subparagraph (6)(iv) of this paragraph).) Such segregation shall be made of charges which make up the balances in the sample accounts as of the end of each customer's last billing-month ending within the taxable year. (See subparagraph (6)(v) of this paragraph for rules to be used in determining which charges make up the balance of an account.) However, in making such segregation, any account to which a sale is charged during the taxable year on which no payment is credited after the billing-month within which the sale is made (hereinafter called the "billing-month of sale") and on or before the end of the first billing-month ending in the taxpayer's next taxable year shall be disregarded and not taken into account in the determination of what percentage of charges in the sample is to

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be treated as sales on the installment plan. In order to obtain a probability sample, the accounts shall be selected in accordance with generally accepted probability sampling techniques. The appropriateness of the sampling technique and the accuracy and reliability of the results obtained must, if requested, be demonstrated to the satisfaction of the district director. If the district director is not satisfied that the taxpayer's sample is appropriate or that the results obtained are accurate and reliable, the taxpayer shall recompute his sample percentage or make appropriate adjustments to his original computations in a manner satisfactory to the district director. The taxpayer shall maintain records in sufficient detail to show the method of computing and applying the sample.

(ii) For taxable years ending before January 31, 1964, a taxpayer who has reported for income tax purposes all or a portion of sales under a revolving credit plan as sales on the installment method may apply the percentage obtained for the first taxable year ending on or after such date in determining the percentage of charges under a revolving credit plan for such prior taxable year (or years) which will be treated as sales on the installment plan. However, in computing the percentage to be applied in determining the percentage of charges under a revolving credit plan which will be treated as sales on the installment plan for such prior taxable year (or years), the rule stated in paragraph (c)(3) of this section shall not apply. See subparagraph (6)(v) of this paragraph for rules relating to the application of payments to finance charges for such prior taxable years.

(3) For the purpose of determining the percentage described in subparagraph (2) of this paragraph, a charge under a revolving credit plan will be treated as a sale on

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the installment plan only if such charge is a sale (as defined in subparagraph (6)(i) of this paragraph) and meets the requirements contained in subdivisions (i) and (ii) of this subparagraph.

(i) The sale must be of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments. If the aggregate of sales charged during a billing-month to an account under a revolving credit plan exceeds the required monthly payment, then all sales during such billing-month shall be considered to be of the type which the terms and conditions of such plans contemplate will be paid for in two or more installments. The required monthly payment shall be the amount of the payment which the terms and conditions of the revolving credit contract require the customer to make with respect to a billing-month. If the amount of such payment is not fixed at the date the contract is entered into, but is dependent upon the balance of the account, then such amount shall be the amount that the customer is required to pay (but not including any past-due payments) as shown on the statement either (a) for the last billing-month ending within the taxpayer's taxable year or (b) for the billing-month of sale, whichever method the taxpayer adopts for all his accounts. A taxpayer shall not change such method of determining the required monthly payment based upon the balance of the account without obtaining the consent of the district director. In any case where the required monthly payment is not set in accordance with a consistent method used during the entire taxable year, the district director may determine the required monthly payment in accordance with the method used during the major portion of such taxable year if he determines that the use of such method is necessary in order to reflect properly the income from sales under a revolving credit plan. The require-

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ments stated in this subdivision may be illustrated by the following examples:

Example (1). Under the terms of a revolving credit plan the required monthly payment to be made by customer A is \$20. During the billing-month ending in December, sales aggregating \$80 are charged to customer A's account, and during the next billing-month, ending in January, sales aggregating \$19.95 and finance charges of \$.60 are charged to A's account. Since the aggregate of sales charged to customer A's account during the billing-month ending in December (\$80) exceeds the required monthly payment (\$20), the terms and conditions of the plan contemplate that the sales charged during such billing-month are of the type which will be paid for in two or more installments. Since the aggregate of sales charged to customer A's account during the billing-month ending in January (\$19.95) does not exceed the required monthly payment, the sales making up the aggregate of sales in such billing-month are not of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments.

Example (2). The terms of a revolving credit plan require a payment of 20 percent of the balance of the customer's account as of the end of the billing-month for which the statement is rendered. A customer makes purchases aggregating \$25 in his next to the last billing-month ending within the taxpayer's taxable year, and the balance at the end of that month is \$150. At the end of the customer's last billing-month ending within the taxpayer's taxable year, the balance of the account has decreased to \$110. If the taxpayer determines the required monthly payment by reference to the payment required on the statement for the last billing-month ending within the taxable year and applies such method consistently to all accounts, then the

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sales making up the \$25 aggregate of sales are of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments. Although such aggregate was less than the \$30 payment ($20\% \times \150) required on the statement rendered for the billing-month of sale, it was more than the \$22 ($20\% \times \110) that the customer was required to pay on the statement rendered for his last billing-month ending within the taxable year, and thus meets the requirements of this subdivision. If, however, the taxpayer determines the required monthly payment by reference to the payment required on the statement for the billing-month of sale, then the sales making up the aggregate of sales during such billing-month do not meet the requirements of this subdivision because such aggregate was less than the \$30 payment required on the statement rendered for such month.

(ii) The sale must be charged to an account on which the first payment after the billing-month of sale indicates that the sale is being paid in installments. The first payment after the billing-month of sale indicates that the sale is being paid in installments if, and only if, such payment is an amount which is less than the balance of the account as of the close of the billing-month of sale. For purposes of this subdivision, such balance shall be reduced by any return or allowance credited to the account after the close of the billing-month of sale and before the close of the billing-month within which the first payment after the billing-month of sale is credited to the account, unless the taxpayer demonstrates that the return or allowance was attributable to a charge made in a month subsequent to the billing-month of sale. The requirements stated in this subdivision may be illustrated by the following examples, in which it is assumed that the taxpayer's annual accounting period ends on January 31.

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Example (1). Customer A's revolving credit account shows the following sales and payments:

<u>Month ending</u>	<u>Aggregate sales in month</u>	<u>Payments</u>	<u>Balance</u>
Dec. 20	\$150	0	\$150
Jan. 20	75	\$ 30	195
Feb. 20	0	195	0

All sales made in the billing-month ending December 20 meet the requirements of this subdivision because the first payment on the account after such billing-month (\$30) was less than the balance of the account as of the close of such billing-month (\$150); and none of the sales made in the billing-month ending January 20 meets the requirements of this subdivision because the balance of the account as of the end of such billing-month was liquidated in one payment. By application of the rules of subparagraph (6)(v) of this paragraph, the balance in the account as of the last billing-month ending in the taxable year (\$195) consists of \$120 of the \$150 of sales made in the billing-month ending December 20 and all of the \$75 of sales made in the billing-month ending January 20. Therefore, \$120 of the account balance meets the requirements of this subdivision and \$75 does not.

Example (2). Customer B's revolving credit account shows the following sales and payments:

<u>Month ending</u>	<u>Aggregate sales in month</u>	<u>Payments</u>	<u>Balance</u>
Dec. 20	\$ 50	0	\$ 50
Jan. 20	100	0	150
Feb. 20	0	\$50	100

None of the sales made in the billing-month ending December 20 meets the requirements of this subdivision because

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the first payment credited to the account after such billing-month (\$50) is not less than the balance of the account as of the close of such month (\$50). All of the sales made in the billing-month ending January 20 meet the requirements of this subdivision because the first payment after such billing-month (\$50) is less than the balance of the account as of the close of such month (\$150).

Example (3). Customer C's revolving credit account shows the following purchases and credits:

<u>Month ending</u>	<u>Item</u>	<u>Charges</u>	<u>Credits</u>	<u>Balance</u>
Jan. 20	Coat	\$55		
	Dress	40		
	Shirt	5		\$100
Feb. 20	Return		\$ 5	
	Payment		95	0

None of the sales made in the billing-month ending January 20 meets the requirements of this subdivision because the first payment credited to the account after such billing-month (\$95) was equal to the balance of the account as of the end of such billing-month, \$95. For this purpose, the balance of \$100 is reduced by the \$5 return which was credited to the account after the close of the billing-month of sale and before the close of the billing-month within which the first payment after the billing-month of sale is credited.

(4) The provisions of subparagraphs (2) and (3) of this paragraph may be illustrated by the following examples in which it is assumed that the taxpayer is a dealer in personal property whose annual accounting period ends on January 31.

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Example (1). Customer A's revolving credit ledger account shows the following:

Month ending	Aggregate sales in month*	Returns and allowances	Payments	Finance charges	Balance
Jan. 20	\$15.00	0	0	0	\$15.00
Feb. 20	0	0	0	\$0.15	15.15

* Including sales of personal property and nonpersonal property sales.

For purposes of the segregation provided for in subparagraph (2)(i) of this paragraph, customer A's account will be disregarded and not taken into account in the determination of what percentage of charges in the sample is to be treated as sales on the installment plan because no payment was credited to that account after the billing month of sale and on or before February 20.

Example (2). This example is applicable with respect to sales made during taxable years beginning before January 1, 1964. Under the terms of the taxpayer's revolving credit plan, payments are required in accordance with the following schedule:

Unpaid balance	Required monthly payment
0—\$ 99.99	\$20
\$100— 199.99	40
200— 299.99	60

Customer B's revolving credit ledger account for the period beginning on September 21, 1963 and ending February 20, 1964 shows the following:

Month ending	Aggregate sales in month*	Returns and allowances	Payments	Finance charges	Balance
Oct. 20	\$55.00	0	0	0	\$55.00
Nov. 20	45.00	0	\$20.00	\$.35	80.35
Dec. 20	20.00	0	20.00	.60	80.95
Jan. 20	26.00	\$ 5.00	20.00	.61	82.56
Feb. 20	0	10.00	72.56	0	0

* Including sales of personal property and nonpersonal property sales.

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The three \$20 payments and the \$5 return or allowance made in the billing-months ending in the taxable year are applied, under the rules in subparagraph (6)(v), to liquidate the earliest outstanding charges, first to the \$55 aggregate of sales in the billing-month ending October 20 and next to \$10 of the aggregate of sales made in the billing-month ending November 20. Thus, the balance of the account as of the close of the billing-month ending January 20, \$82.56, is made up as follows:

Remainder of sales in billing-month ending Nov. 20	
(\$45—\$10)	\$35.00
Finance charge for billing-month ending Nov. 20	.35
Sales for billing-month ending Dec. 20	20.00
Finance charge for billing-month ending Dec. 20	.60
Sales for billing-month ending Jan. 20	26.00
Finance charge for billing-month ending Jan. 20	.61
	<u>\$82.56</u>

The sales of \$35 remaining from the aggregate of sales for the billing-month ending November 20 meet the requirements of subparagraph (3)(i) of this paragraph because the aggregate of sales charged during such billing-month (\$45) exceeds the required monthly payment (\$20), and such sales meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after the billing-month of sale (\$20) is an amount less than the balance of the account as of the close of such month (\$80.35). Therefore, \$35 of sales will be treated as sales on the installment plan. The \$20 aggregate of sales charged during the billing-month ending December 20 does not meet the requirements of subparagraph (3)(i) of this paragraph because it is in an amount which does not exceed the required monthly payment (\$20). (The finance charge of \$.60 added in the billing-month does not enter

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into the determination of the aggregate of sales for the month because the term "sales" (as defined in subparagraph (6)(i) of this paragraph) does not include finance charges). The \$26 aggregate of sales for the billing-month ending January 20 does not meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after such billing-month (\$72.56) was equal to the balance of the account as of the close of such billing-month (\$72.56). For this purpose, the balance of \$82.56 is reduced by the \$10 return or allowance which was credited after the billing-month of sale and before February 20. Thus, of the \$82.56 balance of B's account as of the close of the last billing-month ending within corporation X's taxable year, \$35 will be treated as sales on the installment plan for purposes of determining the percentage provided for in subparagraph (2) of this paragraph.

Example (3). This example is applicable with respect to sales made during taxable years beginning after December 31, 1963. Assume the facts in example (2), except that Customer B's revolving credit ledger account is for the period beginning on September 21, 1964 and ending February 20, 1965. Since payments received are first used to liquidate any outstanding finance charges under the rule in subparagraph (6)(v), the \$20 payment in December liquidated the \$.35 finance charge accrued at the end of the November billing-month and the \$20 payment in January liquidated the \$.60 finance charge accrued at the end of the December billing-month. The balance of the three \$20 payments (\$59.05) and the \$5 return or allowance are applied (under the rules in subparagraph (6)(v)) to liquidate the earliest outstanding sales, first to the \$55 aggregate of sales in the billing-month ending October 20 and next to \$9.05 of the aggregate of sales made in the billing-month ending November 20. Thus, the balance of the account as of the

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close of the billing-month ending January 20, \$82.56, is made up as follows:

Remainder of sales in billing-month ending	
Nov. 20 (\$45—\$9.05)	\$35.95
Sales for billing-month ending Dec. 20	20.00
Sales for billing-month ending Jan. 20	26.00
Finance charge for billing-month ending	
Jan. 2061
	<hr/>
	\$82.56

The sales of \$35.95 remaining from the aggregate of sales for the billing-month ending November 20 meet the requirements of subparagraph (3)(i) of this paragraph because the aggregate of sales charged during such billing-month (\$45) exceeds the required monthly payment (\$20), and such sales meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after the billing-month of sale (\$20) is an amount less than the balance of the account as of the close of such month (\$80.35). Therefore, \$35.95 of sales will be treated as sales on the installment plan. The \$20 aggregate of sales charged during the billing-month ending December 20 does not meet the requirements of subparagraph (3)(i) of this paragraph because it is in an amount which does not exceed the required monthly payment (\$20). The \$26 aggregate of sales for the billing-month ending January 20 does not meet the requirements of subparagraph (3)(ii) of this paragraph because the first payment after such billing-month (\$72.56) was equal to the balance of the account as of the close of such billing-month (\$72.56). For this purpose, the balance of \$82.56 is reduced by the \$10 return or allowance which was credited after the billing-month of sale and before February 20. Thus, of the \$82.56 balance of B's account

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as of the close of the last billing-month ending within corporation X's taxable year, \$35.95 will be treated as sales on the installment plan for purposes of determining the percentage provided for in subparagraph (2) of this paragraph.

(5) Sales under a revolving credit plan which are nonpersonal property sales (as defined in subparagraph (6) (iv) of this paragraph) do not constitute sales on the installment plan. Therefore, the charges under a revolving credit plan must be reduced by the nonpersonal property sales, if any, under such plan, before application of the sample percentage as provided for in subparagraph (2)(i) of this paragraph. The taxpayer may treat as the nonpersonal property sales under the plan for the taxable year an amount which bears the same ratio to the total sales under the revolving credit plan made in the taxable year as the total nonpersonal property sales made in such year bears to the total sales made in such year.

(6) For the purposes of this paragraph—

(i) The term "sales" includes sales of services, such as a charge for watch repair, as well as sales of property, but does not include finance or service charges.

(ii) The term "charges" includes sales of services and property as well as finance or service charges.

(iii) A billing-month is that period of time for which a periodic statement of charges and credits is rendered to a customer.

(iv) The term "nonpersonal property sales" means all sales which are not sales of personal property made by the taxpayer. Thus, sales of a department leased by the tax-

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payer to another are nonpersonal property sales. Likewise, charges for services rendered by the taxpayer are nonpersonal property sales unless such services are incidental to and rendered contemporaneously with the sale of personal property, in which case such charges shall be considered as constituting part of the selling price of such property.

(v) Except as otherwise provided in this subdivision, each payment received from a customer under a revolving credit plan before the close of the last billing-month ending in the taxable year shall be applied to liquidate the earliest outstanding charges under such plan, notwithstanding any rule of law or contract provision to the contrary. For purposes of determining which charges remain in the balance of an account at the end of the last billing-month ending in the taxable year, the taxpayer may apply returns and allowances which are credited before the close of the last billing-month ending in the taxable year either (a) to liquidate or reduce the charge for the specific item so returned or for which an allowance is permitted, or (b) to liquidate or reduce the earliest outstanding charges. The method so selected for applying returns and allowances shall be followed on a consistent basis from year to year unless the district director consents to a change. Additionally, finance or services charges which are computed on the basis of the balance of the account at the end of the previous billing-month (usually reduced by payments during the current billing-month) are accrued at the end of the current billing-month and are therefore considered, for purposes of determining the earliest outstanding charges, as charged to the account after any sales made during the current billing-month. However, for purposes of determining which charges remain in the balance of an account at the end of

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the last billing-month ending in a taxable year which began after December 31, 1963, payments received during such year shall be applied first against any finance or service charges which were outstanding at the time such payment was received. The preceding sentence shall not apply with respect to a computation made for purposes of applying the rule described in subparagraph (2)(ii) of this paragraph.

(vi) The taxpayer shall allocate those sales under a revolving credit plan which are treated as sales on the installment plan to the proper year of sale in order to apply the appropriate gross profit percentage as provided for in paragraph (c) of this section. This allocation shall be made on the basis of the percentages of charges treated as sales on the installment plan which are attributable to each taxable year as determined in the sample of accounts described in subparagraph (2) of this paragraph. However, if the taxpayer demonstrates to the satisfaction of the district director that income from sales on the installment plan is clearly reflected, all sales may be considered as being made in the taxable year for purposes of applying the gross profit percentage.

(7) The provisions of this paragraph may be illustrated by the following example:

Example. Corporation X is a dealer in personal property and has elected to report on the installment method those sales under its revolving credit plan which may be treated as sales on the installment plan. Corporation X's taxable year ends on January 31, and the total balance of all its revolving credit accounts as of January 31, 1964, is \$2,000,000. The total sales made in the taxable year are \$10,000,000 of which \$500,000 are nonpersonal property sales. The gross profit percentage realized or to be realized

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on all sales made in the taxable year is 40 percent. The amount of the gross profit contained in the year-end balance of \$2,000,000 which may be deferred to succeeding years is computed as follows:

(i) In order to reduce the charges appearing in the year-end balance of revolving credit accounts receivable by the nonpersonal property sales contained therein, corporation X determines the amount of such nonpersonal property sales under the method permitted in subparagraph (5) of this paragraph. Corporation X first determines the ratio which total nonpersonal property sales made during the year (\$500,000) bears to total sales made during the year (\$10,000,000), and then applies the percentage (5%) thus obtained to the year-end balance of revolving credit accounts receivable (\$2,000,000). The nonpersonal property sales thus determined (\$100,000) is subtracted from such year-end balance to obtain the charges under the revolving credit plan appearing in the year-end balance (\$1,900,000) to which the sample percentage is to be applied.

(ii) In accordance with generally accepted sampling techniques, the taxpayer selects a probability sample of all revolving credit accounts having balances for billing-months ending in January 1964. The technique employed results in a random selection of accounts with total balances of \$100,000.

(iii) Analysis of these sample accounts discloses that of the \$100,000 of balances, \$10,000 of balances are in accounts on which no payment was credited after a billing-month of sale and on or before the end of the first billing-month ending in the taxable year beginning February 1, 1964. These balances are, therefore, disregarded and not taken into account in the determination of what percentage of sales

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in the sample is to be treated as sales on the installment plan. Of the remaining \$90,000 of balances, the taxpayer determines, by analyzing the ledger cards in the sample, that \$63,000 of balances are composed of sales which meet the requirements of subparagraph (3)(i) and (ii) of this paragraph and are thus treated as sales on the installment plan. The remaining \$27,000 of balances either did not meet the requirements of subparagraph (3)(i) or (ii) of this paragraph or were not sales (as defined in subparagraph (6)(i) of this paragraph). The percentage of charges in the sample treated as sales on the installment plan is, therefore, 70 percent ($\$63,000 \div \$90,000$).

(iv) The charges in the year-end balance which are to be treated as sales on the installment plan, \$1,330,000, are computed by multiplying the charges determined in subdivision (i) of this subparagraph (\$1,900,000) by the percentage obtained in subdivision (iii) of this subparagraph (70%).

(v) The deferred gross profit attributable to sales under the revolving credit plan for the taxable year, \$532,000, is determined by multiplying the amount determined in subdivision (iv) of this subparagraph, \$1,330,000, by the gross profit percentage, 40%. (Corporation X will be able to demonstrate to the satisfaction of the district director that (a) since the gross profit percentage for all sales does not vary materially from the gross profit percentage for all sales made under the revolving credit plan, (b) since only an insubstantial amount of sales included in year-end account balances was made prior to the taxable year, and (c) since the prior year's gross profit percentage does not vary materially from the gross profit percentage for the taxable year, income from sales on the installment plan will be clearly reflected by applying the current year's gross

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profit percentage for all sales under the revolving credit plan created as sales on the installment plan.)

(e) *Treatment of payments on sales made in years prior to change to installment method.* No payments received in the taxable year shall be excluded in computing the amount of income to be returned on the ground that they were received on a sale the total profit from which was returned as income during a taxable year or years prior to the change by the taxpayer to the installment method of returning income. In this regard see section 453(c) and § 1.453-7 for the method of determining the sales on which the payments shall not be excluded and the computation of the adjustments for amounts previously included in income in the case of a change from the accrual method to the installment method. Deductible items are not to be allocated to the years in which the profits from the sales of a particular year are to be returned as income, but must be deducted for the taxable year in which the items are "paid or incurred" or "paid or accrued." See section 461 and the regulations thereunder, and section 7701(a)(25).